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MONEY-CHANGING

AN INTRODUCTION TO FOREIGN EXCHANGE

BY

HARTLEY WITHERS

AUTHOR OF "THE MEANING OF MONEY," "STOCKS AND SHARES," ETC.

"La science est infaillible ; mais
les savants se trompent toujours."
ANATOLE FRANCE.

NEW EDITION

LONDON
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PREFACE TO NEW EDITION

It seems at first sight that war, on its present scale, puts the laws of exchange in the dustbin. Rates have gone skyrocketing and diving with an almost indecent disregard for precedent, and the old "gold points" are a half-forgotten memory. And yet above the war flood which has drowned so many of the landmarks by which the students of exchange were taught to steer, there still rise, serene and stronger than ever, the pillars on which the chief laws of this science are engraved. The war has shown more clearly than ever that claims on account of goods, services, and securities (in the widest sense of the term) are the foundation on which rates of exchange are built, and that variations in the amount of these claims are the chief causes of the movements in these rates. The violence of these movements, under war conditions, makes their meaning all the plainer; and if the details of text-books are belied for the time being, that is only because the main principles that they set forth are now freed from many of the modifications which veil their working in time of peace.

HARTLEY WITHERS.

6, Linden Gardens, W.
July, 1916.

PREFACE TO FIRST EDITION

A BOOK on Foreign Exchange is a venture that I should never have attempted had I not been invited to lecture on the subject to members of the Institute of Bankers. In preparing my lectures, I was able to draw freely on the ripe experience of the President of the Institute and others, without whose help neither the lectures nor this book could have come into being.

February, 1913. HARTLEY WITHERS.

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MONEY-CHANGING

CHAPTER I

MONEY AT HOME AND ABROAD

"It is awful to read on the currency," says Walter Bagehot in his "Literary Studies," and to read on the currencies of the nations, and their prices as expressed in one another, is awful with an awesomeness that is worldwide and appalling. Nevertheless the subject has a certain fascination when one reaches the root of the matter, after digging through the heavy ground that has to be broken in the opening chapters. It was a proud moment in my life when, in lecturing on Foreign Exchange, I was rewarded with hearty laughter from my audience, and I mention the fact as an encouragement to any reader who may be shivering on the brink of this treatise. The lectures were a series delivered, in London and

Manchester, before members of the Institute of Bankers, and out of them this book has grown.

Foreign Exchange means the buying and selling of the money of other countries, and is handled in the same way as the buying and selling of most other things. If there is a strong demand for foreign money its price goes up, and that of the local money goes down, and if there is a great supply of foreign money coming to be sold, the movement is the other way. If a number of people in Paris have debts to pay in England, they will bid in francs for sovereigns. Their bidding will raise the price of sovereigns, as expressed in francs. The price of sovereigns as measured against francs will rise; that of francs as measured against sovereigns, will fall. Buying and selling means the exchanging of anything for money, so when it is said that Foreign Exchange means the buying and selling of the money of other countries, that is another way of saying that Foreign Exchange, from the English point of view, is the business of exchanging foreign money into English money. In other words, Foreign Exchange is the Science and Art of international money-changing. The Science teaches us to think about it, to know

about it, and to talk about it, and the Art is concerned with the much more difficult problem of going into the market and dealing in it.

This being so, we have first to consider what we mean when we speak of money, and to see whether there is any essential difference between English money and foreign.

Money has several meanings. If we say colloquially that Mr. Crœsus has heaps of money, we mean that he has great possessions in land or mortgages, or stocks and shares, or factories or businesses, from which he draws a big income. Or, if the newspapers say that money in the City is scarce and dear, they mean that bankers are not lending freely, and are charging high prices for loans. But more usually money means a piece of paper or metal with which we pay for what we want, and for which we workers sell our labour; and this is the sense in which I use the word when I say that Foreign Exchange is the business of money-changing.

These pieces of metal or paper are taken in payment, either because they are "legal tender," or because those who take them do so of their own free will. When a coin or note is legal tender, that means to say that if you have a debt to pay, your

creditor cannot refuse to take it in due discharge.

In this country sovereigns are legal tender up to any amount, and likewise Bank of England notes. But it should be observed that the Bank of England note is not legal tender if tendered by the Bank of England. If a note is presented to the Bank it cannot meet it with another note, but has to pay sovereigns against it. Silver and copper are only legal tender for small amounts — silver up to forty shillings and copper up to one shilling — and the cheques, with which the majority of commercial transactions are settled, are not legal tender at all. They could not be made legal tender, for it would be most unfair to make a creditor accept, in payment of a debt, a piece of paper which might, or might not, be honoured by the bank on which it is drawn. In practice, however, a dishonoured cheque is so rare an event in comparison with the huge number of them that is drawn and passed through the Clearing House every day, that a cheque on an English bank drawn by a solvent person is generally considered as good as so many sovereigns. Anyone who has such a cheque in his pocket can turn it either directly into sovereigns, or into Bank of England

notes and so into sovereigns. If the cheque has been "crossed," by two lines drawn across its face, he can only do so by paying it in through his own bank; if not, he can go to the bank on which it is drawn and turn it directly into legal tender money. The bank on which it is drawn may, if it chooses, meet it in Bank of England notes; then the holder of the notes can go across to the Bank of England, which has to meet its notes in sovereigns.

In England, then, all the money that we use, except the small change of retail traffic, consists either of gold, or of paper that can unquestionably and immediately be turned into gold.

As soon as we cross the sea we find that other people's money does not carry with it the same unquestioned right of being forthwith turned into gold that is borne by our English currency. Not one of the other leading commercial countries undertakes this task of giving everybody, who carries a piece of paper conferring the right to a certain amount of money, the choice of turning it into gold if he wants to do so.

In France the Bank of France can meet its notes in five franc pieces, and it often does meet demands on its gold store by the simple method of

charging such a premium for gold that it does not pay to take it for export.*

In Germany the right to gold is established in theory, but does not exist in practice except when it is convenient to Germany. On paper, the notes of the Reichsbank can be turned into gold on demand. What devices the Reichsbank uses in order to check demands on its gold, when it does not want to meet them, is a question that can only be answered by those who have made the experiment. That some devices are used is very practically and definitely proved by the fact that the rate of exchange in Berlin sometimes rises well above the point at which it would pay to send gold from Berlin to London if it could be got, without any gold coming.* The inference is irresistible that the gold was not to be had, or at least that the quick and skilful German bullion dealers thought it more prudent to forego the profit that was to be earned by taking it. The same system is found in most of the European countries. They have a gold standard, more or less, on paper, but they do not part with gold in payment of their notes unless they are so minded.

* The meaning of these dark sayings is made clear later on. It is impossible, in the early pages of a treatise of this kind, to avoid expressions that have not yet been explained.

In the United States convertibility of legal tender currency is established by legal enactment, though the laws that deal with the subject are so complicated that many American bankers and business men have assured me at various times that this is not so. The hitherto existing law of the matter, however, is not a very practical question, in the first place because the United States have in the past been subject to periodical panics, the latest example of which occurred in 1907, in which the American banks took the law into their own hands and refused to meet the demands of their depositors for cash, except in the shape of a curious form of currency called "clearing-house certificates;" and in the second place, because a new order of things is now established, and new currency arrangements have been made, the effect of which in actual practice has yet to be seen. Those who have instituted these new arrangements hope that thereby these panics will be made impossible, and the rest of the financial world devoutly prays that this hope may be fulfilled.

There is also a large class of countries which have arrived at what may be called the half-way

house in the matter of currency, and have established a sort of one-sided system, with an option in their own favour. Chief among these are India, Japan, Mexico, Argentina and Brazil. These countries have what is called a gold exchange standard, because a certain exchange value for their currencies is fixed by law as the price at which they are to be maintained. They will all, if gold is brought to them, issue currency, whether silver or paper, in exchange for it, but they do not undertake to turn all their legal tender currency into gold. They do, however, maintain some steady relation between their money and gold, since they take measures for holding up the price of their currencies at a certain exchange value as compared with English sovereigns or American dollars.

This system was discovered by Holland, which used it in Java, and was adopted by the Indian Government, which in 1893 closed its mints to the free coinage of silver and set about the task of raising the exchange value of the rupee. It was a bold and hazardous enterprise which caused much head-shaking among the economic pundits of the period. The advisers of the Indian Government assumed that, if it left off coining new rupees, the natural growth of the country's trade, and

consequent need for currency, would give the rupee a scarcity value and so raise its price as expressed in English money. Hence they hoped that, whatever might happen to the price of silver in the outside world, the rupee would circulate, as a token coin, at an exchange value which would gradually advance. And they were right, after a year or two of doubt and anxiety during which the laugh seemed to be on the side of their critics. In 1894–5, the exchange value of the rupee was 13·1*d.* In 1899–1900, it was 16*d.* * At 16*d.* the Government will issue rupees against gold, paid to it either in India or in London, so that the demands of India for more currency can at any time be met. Since 1900, the stability of the rupee has been successfully maintained, except for a short time in 1907, when the American crisis shook the whole world's credit system to its foundations and India suffered from a series of misfortunes of its own.

It was the original intention of the Indian Government that this one-sided system should be temporary, and should be replaced later by a gold

* "The Standard of Value," by Sir David Barbour, p. 208. Sir David was one of the authors of the new standard, and his work gives a most interesting account of its conception and creation.

standard and a gold currency; and it is constantly being urged by well-meaning critics to carry out the final stage of its reform. Whether it should do so, is a very open question. It seems to have stumbled on an ideal arrangement, for a comparatively poor country, in its present system. A genuine gold standard, such as we enjoy in England, is a pleasant luxury for a rich nation, and also pays for itself, in our case, by the supremacy that it gives us in international banking. But till the time comes when India is ready to be the world's banker, it does not want a gold standard, still less a gold currency. It has got a gold exchange standard, by which the rupee is kept at or near its legal price, by the maintenance of balances in London, out of which the Government can supply English money whenever the demand for it in India becomes so keen that the purchasing power of the rupee, as expressed in English money, is threatened with depreciation. In other words, it can supply the Indian exchange market with English money whenever competition for it is tending to depress the price of the rupee too far.

Thus the rupee has greater stability than the French franc, or the German mark or the Russian

rouble, and in the meantime India is saved the expense of a gold currency, or of the huge gold reserve that France, Germany and Russia think it necessary to keep. Part of the Indian balances in London is held in gold. The rest is invested or lent in the London market and so is a source of revenue to India. It may not always have been wisely invested. It is easy now to look back and say that India ought not to have bought Consols, but confined itself, like the shrewd Japanese, to Treasury bills and other short-dated securities. But it does not therefore follow that the Indian Government would be wise in turning the whole of its London balances into gold and sending them to India, as it is sometimes urged to do. Its present system combines simplicity with cheapness. It keeps the rupee steady, and it gives India a currency on which the Government makes a pleasant profit. For exchange purposes India does not want a heap of gold in India, but a fund at its credit in London to be drawn on in time of need.

This exchange standard system, by which the supply of currency in a country is regulated by its only being issued against deposits of gold, and the exchange is maintained by drafts on the

Government's balance in London, has been successfully adopted by several other nations. Originally designed as a makeshift, it is in many ways more business-like and satisfactory than the system by which the chief European countries have a fictitious gold standard, with an enormous hoard of gold behind it, and yet cannot keep their exchanges steady. The gold exchange standard gives a country the great advantage of a cheap currency, especially if the currency be made of paper, and though it does not give the currency the right to be turned into gold on the spot, it gives it the next best thing, a steadily maintained exchange value, or power of purchasing sovereigns.

Then there are the few silver-using countries, of which the only important survivor is China and the few economic outcasts which still print paper money without any attempt to regulate its exchange value.

We find then that the money, the exchange of which is the subject-matter of the Foreign Exchanges, may be divided into several classes.

First, there is the English system under which money carries with it the unquestionable right to be forthwith turned into gold.

Secondly, there is that of the so-called gold

standard countries under which money can be turned into gold when it is convenient to the bankers, or central banks, of the countries in question.

Thirdly, there is that of the half-way house countries which have a semi-gold standard and will accept gold and issue silver or paper currency against it, but do not undertake to turn the silver and paper currencies into gold on demand, though they take measures to keep up their exchange value.

Fourthly, there are the few purely silver-standard countries.

Fifthly, there are the few purely paper-money countries.

Of these the first is the only one that has any right to be considered a real workman-like currency for a country that is attempting to do international banking business, and as long as England is the only country that enjoys it England will hold its place as the world's banker. For it is only in England that a man who is paid a sum of money is given thereby the right to a lump of metal which, wherever it is taken or sent all over the economically civilized world, is sure to give him command of a certain amount

of the goods and services that are there to be purchased. Everywhere else the currency in which he receives payment is quite useful and serviceable in the country of its origin, but gives no necessary right to the one medium of exchange that is welcomed wherever men trade.

It may be absurd enough that this feature of an intrinsic value behind a currency should be necessary, and that hence the monetary convenience of the financial and commercial world should be seriously affected by the rapidity, or slowness, with which a certain metal is dug out by miners groping for it underground. It may be quite true that the value of gold is a mere convention, that gold is a quite useless metal except to dentists, and that the only reason why anybody can possibly want a bit of it, is because he believes that everybody else wants it. All this may be quite true, but the fact remains that, owing to this convention, however it may have arisen, everybody does want gold, because everybody can turn it into anything that he wants that is to be had for money. And to the student of the vagaries of exchange it is very important to grasp at an early stage the varying degree of intrinsic value that is behind the different

currencies of the world; because he will find as he goes further that this influence is powerful in warping the working of the rules and regulations that have been laid down by theoretical lawgivers in the realm that he proposes to explore.

CHAPTER II

RATES OF EXCHANGE

HAVING taken a preliminary survey of the various kinds of money, the relative values of which and the system by which they are turned into one another are the subject-matter of Foreign Exchange, we can proceed to consider the daily table of exchange rates that is quoted in the daily press. An example, taken from the *Times*, appears with a translation on the opposite page.

The first thing that strikes one about the table as one looks down it, is the fact that most of the quotations are in foreign money and express the amount of the foreign money that is, at the current rate, paid for one sovereign. This form of quotation is natural enough, seeing that the rates quoted are those current in the various foreign centres—the Paris quotation being telegraphed from Paris and so on—but it adds very much to the early difficulties of the struggling

FOREIGN EXCHANGES.

	November 1880.	
Paris, sight	25f. 22½ 23c.	= francs and cents to £1
Bordeaux, sight	25f. 36–37½c.	" " "
Berlin, sight	20m. 4½–5½pf.	= marks and pfennigs to £1
" 2 days	20m. 45pf.	" " "
Vienna, sight	24fl. 21½–24fl.	= florins and kreuzer to £1
Amsterdam, sight	12fl. 05½–7c.	= florins and cents. to £1
Italy, sight	25lr. 49½–51½c.	= lire " "
Switzerland, sight	25f. 24–30.	= francs " "
Madrid, sight	26p. 24–34.	= pesetas to £1
Lisbon, sight	4600 reis.	= reis to 1 sterling
St. Petersburg, 3 months	93r. 85.	= roubles and kopeks to £10
" sight	96r. 22–32.	" " "
Christiania	18kr. 21½–65.	= kroner and öre to £1
Copenhagen	18kr. 21½–65.	" " "
Stockholm	18kr. 23½–65½.	" " "
Bombay, T.T.	1s. 4 1/16d.	= pence to 1 rupee
Calcutta, T.T.	1s. 4 1/16d.	" " "
Hong-kong, T.T.	2s. 0 7/32d.	" " dollar
Shanghai, T.T.	2s. 1 1/32d.	" " tael
Singapore, T.T.	2s. 4½d.	" " dollar
Yokohama, T.T.	2s. 0 7/32d.	" " yen
Alexandria	Pi. 97½.	= piastres to £1
Rio de Janeiro, 90 days	16½d.	= pence to 1 milreis
*Valparaiso, 90 days Bank	9 7/32d.	" " dollar
* Buenos Ayres, 90 days	48 1/16d.	" " "
* Montevideo, 90 days	52 3/32d.	" " "

* These rates are telegraphed on the day preceding that receipt.

student, because it is contrary to the method in which the prices have been expressed of everything that he has hitherto been used to think of as having a price. Having always thought of an umbrella as worth half a sovereign upwards, according to quality, and pricing a hat according

to the number of shillings that are wanted to purchase it, it gives his mental digestion a very uncomfortable twist when he is suddenly asked to turn the process the other way round, as if umbrellas were to be quoted at 2 and hats at $2\frac{1}{3}$. And this is not the worst of it, for a still more confusing consequence of this reversal of the usual method of quotation is the fact that it makes movements in prices go the wrong way round, or seem to do so. For instance, since the Paris exchange expresses the value of a sovereign in francs, anyone who wants to buy francs will buy them cheaper the higher the price is. It is clear enough as soon as you think it out, because you want your sovereign to buy as many francs and fractions thereof as possible, so that you deal on better terms when you get 25 francs 30 centimes than when you only get 25 francs 29 centimes; but it is very difficult at first to avoid the confusion caused by the ingrained habit of thinking that a low figure means a cheap bargain. If the system were applied all round it would soon be clear. If umbrellas were quoted at so many to the sovereign, we should quickly learn that they were cheaper at 2 than at $1\frac{7}{8}$. But as it is, this contrariwise

method of quoting exchanges remains a pitfall, not only to beginners, but to many who might have been expected to have mastered it.

If the rates of exchange were all quoted in the same way, it would be easy enough, with a little practice, to accustom one's mind to giving itself the necessary twist in approaching them, and to remaining twisted throughout one's study of the table. But, as we look down the list, we find that it has a plentiful lack of consistency in this respect. When we come down to Lisbon we have to untwist our minds and adapt them to a rate which is quoted in English pence—so many pence to the Portuguese milreis—so that here the whole process is turned round, and the lower the quotation the more favourable it is to the English buyer of Portuguese currency, because a smaller number of pence buys him money in Lisbon. Then we have to twist ourselves back again for the rest of the European currencies, but when we get to the Oriental monies—Indian, Chinese and Japanese, and Straits Settlements—they are quoted in pence again; then comes Egypt, with the Alexandrian rate in piastres and back again to pence for the South American rates.

Two more difficulties lurk in this table of rates, which almost looks as if it had been specially designed to confuse the beginner, but has, in fact, merely adapted itself to business convenience and the needs of those who want information, in the shape most useful to themselves, about the subject matter of their daily trade. The first difficulty is a small one because it only affects one rate. All the rates, save one, quoted in foreign money, give the amount of that money that will buy one English sovereign. That one is the St. Petersburg rate, which gives the number of roubles that will buy ten English pounds. The quotations given in English currency in all cases show the number of shillings and pence that one local coin or piece of paper will fetch—one rupee for sixteen pence and a fraction in Calcutta, one yen for two shillings and nearly a halfpenny in Yokohama, and so on.

Our second difficulty is a question of time. Most of the rates quoted state the time when the money is due, and these times vary. We begin with the Paris cheque, which is quoted at 25 francs $22\frac{3}{4}$ centimes. The meaning of this quotation is, that on the day on which it was current, a cheque on a London bank or firm for £1 was priced in

Paris at 25 francs and 22¾ centimes. Now a cheque as everyone knows, is payable at once or on demand, so that any one who buys this cheque and sends it to London for collection enables the person to whom he sends it to get his money at once. Consequently when we go on to Berlin and find a "sight" rate quoted, it is natural to suppose that there is some slight shade of difference between a cheque and a draft payable at sight. This, however, is not the case. The quotation first of a Paris cheque and then of a Berlin sight rate is merely a variation introduced by the unconscious practical jokers who have in the course of years composed the medley of confusion represented by the table of exchanges. The sight draft is payable at sight, that is to say on demand, and so is exactly the same thing, in practical effect, as a cheque. The next item in the list is the Berlin eight days' rate, and here the element of time comes into the price. The Berlin sight rate is 20 marks 48¾ pfennigs, which is to say that a sight draft on London for a sovereign will fetch in Berlin 20 marks and 48¾ pfennigs, while the eight days' rate is 20 marks 45 pfennigs, this being the price in Berlin of a draft on London payable eight days after sight, that is to say eleven days after it has been

presented to the party drawn on, and "accepted" by him. When a draft is accepted, it means that the company or firm whom it orders to pay intimates by its signature across the face of the draft that it will pay the amount named on the due date. The eight days have grown into eleven by the addition of the three "days of grace" which are always allowed in England for the payment of a draft that is payable after an interval. In the case of a cheque or a sight draft payment is immediate, and there are no days of grace; in that of a draft payable one day or six months after sight, the days of grace have to be allowed for.* It is thus clearly natural that the price of a draft on London payable eight days after sight should be lower in Berlin—or anywhere else—than that of a draft payable at sight, since the former only gives the holder the right to his money eleven days after its receipt and is, therefore, less valuable than one which carries the right to immediate payment. This difference is expressed in the quotations here given by $3\frac{3}{4}$ pfennigs to the pound, but it varies, of course, in accordance with the rate for money

* The question of the bill stamp has also to be considered, since it is 1*d.* on drafts for any amount payable within three days after date or sight, but $\frac{1}{2}$ per mille *ad valorem* on drafts with longer currency.

current in the city on which the draft is drawn. It naturally follows that the longer the time that has to run before the draft is payable, the bigger the difference will be between its value and that of the sight draft. When we get down to St. Petersburg again, we find the three months' rate quoted at 93 roubles 85, and the sight rate more than a rouble higher at 95 roubles 27, this difference being clearly due to the greater value of a draft entitling the holder to cash on demand as compared with one which gives him the right to cash three months later.

Yet another variety of rate is found when we come to the gorgeous East and find ourselves handling rupees and taels and yen. Owing to the length of time that a mailed remittance takes to arrive, the commonest monetary dealings between the East and London are in the form of telegraphic transfers, "T.T.'s" as they are usually called, so that rates for these show the price at which a pound in London, to be paid as soon as a telegram can be flashed along a wire, can be bought or sold in Calcutta or Shanghai or Yokohama, or wherever the rate may be quoted.

Alexandria, like the Scandinavian places, does not specify time with its rate, but both of these

are in fact sight rates. When we come to South America, we find Rio, Valparaiso, Buenos Ayres and Montevideo all quoting 90 days' rates, showing the number of pence that will be given for the Brazilian milreis or the Chilian, Argentine or Uruguayan dollar, ninety-three days, including the days of grace, after the draft has been presented for acceptance in London.

On a separate table, which is printed apart from the others in the newspapers because it is

	To-day.	Prev. day.
Exchange on London, sight	4.84.55	4.84.45
„ Cable Transfers	4.85.05	4.84.95
„ 60 days' sight	4.80.50	4.80.40
„ Berlin, short sight	94⅝ less 1/16	94⅝
„ Paris, ditto	5.20 less 1/16	5.20 less 1/16

received at a much later hour, we find the New York rates. This table gives us a considerable variety, because business between New York and London is on so great a scale that it is necessary to quote drafts with different periods to run. Here then we have the sight rate, the cable transfer, corresponding to the Oriental T.T., and the sixty days' sight rate. Their meaning ought to be already clear, but perhaps it is safer to repeat that the cable transfer expresses the amount in dollars that will be paid for a pound

in London, payable by telegram: the sight rate is the amount in dollars payable for a pound in London, payable when the draft has been sent across the ocean and presented; and the sixty days' sight rate is the amount in dollars payable for a pound in London payable sixty-three days—throwing in the days of grace—after the draft has been received in England, presented and accepted. As we should expect, we find the cable transfer is most expensive because it confers the right to prompt cash, while the sixty days' draft costs least, because its holder has to wait longest for his money.

The New York table also quotes Berlin short sight; this rate means the number of American cents that will be given in New York, for 4 marks in Berlin, payable eight days after sight. The American cent is a hundredth part of a dollar, the American dollar is worth rather more than four English shillings, and the German mark is worth rather less than an English shilling. Consequently we find that it takes about 94½ hundredths of a dollar to buy 4 marks.

The Paris rate in the New York table gives the number of francs in Paris that the dollar in New York will fetch.

It has already been noted that these daily tables of rates of exchange quoted in the London papers are composed of quotations sent by telegraph from the various foreign centres, and express the prices there current for English money. Twice a week only we get the other side of the picture, when on Wednesdays and Fridays we find a table printed of the Course of Exchange, giving the rates quoted on the preceding days for foreign currencies in London. Dealers in foreign bills, that is to say in bills payable in foreign countries, meet and traffic in the Royal Exchange on Tuesdays and Thursdays, and the list that appears next day is a record of their business. The specimen on the opposite page is taken from the *Times*.

It should be noted that in this list the Dutch rate is in florins and stivers (a stiver = 5 cents), whereas in the daily list given above it was in florins and cents. The Spanish rate is here in pence to five pesetas, the Russian rate is in pence to the rouble, while the New York rate is in pence to the dollar. It should also be noted that in this table, which looks at the exchanges the other way round, the longer dated draft, being less valuable, has the higher rate, because from

—		Thursday, Nov. 28th.		—
Amsterdam, &c.	cheques	12 1⅞	12 2⅛	florins and stivers to £1
,, ,,	3 months	12 4¾	12 5¼	,, ,, ,,
Antwerp and Brussels	,,	25 67½	25 72½	francs and cents ,,
Hamburg ...	,,	20 79	20 83	marks and pfennigs to £1
Berlin, &c. ...	,,	20 79	20 83	,, ,, ,,
Paris	cheques	25 21¼	25 23¾	francs and cents ,,
,, ...	3 months	25 46¼	25 51¼	,, ,, ,,
Marseilles ...	,,	25 47½	25 52½	,, ,, ,,
Switzerland ...	,,	25 63¾	25 68¾	,, ,, ,,
Austria	,,	24 59	24 63	kronen and heller ,,
St. Petersburg and Moscow	,,	24¾	24⅞	pence to one rouble
Genoa	,,	25 88¾	25 93	lire and cents to £1
New York ...	60 days	48⅝	48¾	pence to one dollar
Madrid ...	... 3 months	43⅞	44⅛	,, five pesetas
Lisbon	,,	46 1/16	46 5/16	,, one milreis
Oporto	,,	46 1/16	46 5/16	,, ,,
Copenhagen ...	,,	18 51	18 55	kronor and ore to £1
Christiania ...	,,	18 52	18 56	,, ,, ,,
Stockholm ...	,,	18 52	18 56	,, ,, ,,

London's point of view the higher rate is the lower price. London gives a sovereign for 12 fl 2 stivers when it is a question of an Amsterdam cheque, but wants 12 fl. 5 stivers for its sovereign when the draft is for three months.

This list is much less important and is scanned much less carefully, than the daily table of rates cabled from abroad, because most of the business of which the foreign exchange rates are the record and expression is done, not in London, but in the

foreign commercial centres. This is so, because many more bills are drawn on London by merchants and others abroad, than are drawn by London on its foreign trade connexions, a fact which will be explained later when we come to close quarters with the mechanism of exchange. So far I have said as little as possible about bills and drafts, because I wanted to make it as clear as possible that the subject matter of the exchanges is the traffic in foreign monies and the prices at which they are changed into English sovereigns. Now that this leading principle of the business has been made clear, we can go a step further and explain that the actual exchange of dollars into sovereigns, for example, is carried out by the purchase in New York of a claim to so many sovereigns in London, and that this claim is contained in a bill of exchange or draft, which, if payable at sight, that is on presentation, may be called a cheque or sight draft.

A bill of exchange is legally defined as "an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed or determinable future time, a certain sum in money to, or to the

order of, a specified person, or to bearer." There is nothing like a legal definition for obscuring the meaning of things to the lay mind. A bill of exchange may be described in plain language as an order to pay. The cheque that I draw on my bank telling it to pay two pounds nine and six to my butcher is a bill of exchange. The draft by which a foreign Government that has just raised a loan in London orders its bankers to pay half a million to a ship-building firm towards the cost of a Dreadnought on the stocks is a bill of exchange. Bills of exchange in the form of cheques —which are bills payable on demand and drawn on a bank—are the kind of money most used in home trade, and bills of exchange payable at sight or at any date up to six months after sight, are the form of currency almost exclusively used in trade between nation and nation. At home we use coined cash to a certain extent, chiefly for small transactions. In international trade we use metal, in bars or coin, only on the comparatively rare occasions when it is not possible to square the account between one people and another by any other means, or when some foreign centre finds it necessary to take gold, when it would have been cheaper to settle by bills, because gold is

needed to underpin its credit fabric, or, perhaps, for spectacular effect on the local stock market.

The bill, or order to pay money in a foreign centre, is thus the commodity that is actually bought and sold by dealers in foreign exchange, but it is better for the moment to leave bills out of consideration. They are only the tangible expression of the claim for money in another centre, and at this early stage of our inquiry it is better to keep our minds fixed on what is at the back of the bill, namely the money in a foreign centre to which it gives its holder a claim. The French buyer of a bill on London buys it, as a rule, because by sending it to his English correspondent he can discharge a debt to him in English money. What he really buys with his francs is so many English pounds, and the labyrinth of the foreign exchanges is much easier to thread if, before we complicate the question by talking about bills, we keep our eye on the comparatively simple problem which is the key to the puzzle, namely the exchange of one country's money for another's.

Thus stripped to its naked simplicity, the problem begins to look as if it were not a problem at all, and a critical inquirer may be excused for thinking that at least in the case of countries that

use currencies based on the same metal, there ought to be no need for daily quotations of rates of exchange, because the relative value of their monies ought to be constant. It is a natural question to ask, why should there be these daily fluctuations, and since they are evidently there, what is the sense or purport of them? The answer is, that money in France and money in England are two different things, and the relative value of any two different things is almost certain to fluctuate. Quite apart from any differences in the fineness of gold coined by two different countries, or the ease or difficulty with which a credit instrument can be turned into gold, mere distance is quite enough to make the difference that will create fluctuation in price. New York and Chicago use exactly the same currencies, but money in New York differs from money in Chicago by being nearly a thousand miles away, and consequently there are frequent variations in their relative value. The English and Australian sovereigns are identical in weight and fineness, but there is constant fluctuation in the buying power of the English sovereign as expressed in its brother that is circulating in the Antipodes.

These fluctuations are based on the same influence that sways the movements in the prices of all goods and services that are bought and sold, that is, the influence of supply and demand. Just as the price of boots, Consols, medical advice, football professionals, or anything else that can be the subject of a bargain, will depend in the end on the number of people who want to buy them compared with that of those who want to sell them, at or near a certain figure, so the price of English pounds, when expressed in francs, guilders, milreis, or Australian sovereigns, depends on the number of people abroad who have to buy money in England as compared with the number of those who have money in England to sell. People abroad have to buy money in England when they owe money to Englishmen and want to pay it; and they have money in England to sell when Englishmen owe them money.

Jacques Bonhomme in Paris has been selling shiploads of Christmas kickshaws to John Robinson in London, and so has thousands of English pounds due to him by the said Robinson. But English pounds, as such, are not wanted by M. Bonhomme. He wants to sell them, to turn them into francs, the currency of his own country, with

which he makes his daily payments at home. On the other hand, there are always plenty of Frenchmen who have imported English goods or have had services rendered by English bankers, or shipowners, or insurance companies, and so want to buy English money wherewith to pay their English creditors. So it follows that the price that M. Bonhomme will get for his English pounds will depend on the value of goods and services that other Frenchmen have been selling to England, so producing English pounds to be sold in Paris, as compared with the value of the claims that have to be met in London, for the satisfaction of which English pounds have to be bought. If the amount of English money on offer is bigger than the amount wanted, down will go the price of the English pound as expressed in francs, and the seller will get less in francs for his pound. If the amount of English money wanted is the bigger, the price will go up, and the seller will get more for his pound. When the price goes down, the exchange is said to move against London, because there is a depreciation in the value of the sovereign as expressed in francs; when it goes up the exchange moves in favour of London, because the buying power of the sovereign is enhanced.

The process is exactly the same, and is even more simple and easy to understand when we take away the complication of the exchange of the monies of two different nations, and look at it at work between two distant towns of the same country. If in the course of trade New York has large payments to make in Chicago, money in Chicago will be wanted in New York, and competition there will send up the price of it, so that a dollar in Chicago will be worth more for the time being to New Yorkers than a dollar in New York, and any New York bank or firm that has a balance or a credit in Chicago will be able to dispose of it at a premium. The extent of this premium, however, will obviously be limited by the expense involved of sending lawful money, as the Americans call it, from New York to Chicago. If we suppose, for the sake of simplicity, that the cost of sending a dollar and insuring it is covered by a cent, no one in New York will pay much more than one dollar and a cent for a dollar in Chicago. Rather than do so he will send his dollar. He will probably pay a small fraction more to save himself the trouble and time involved by sending and insuring money, and this minute fraction that he will sacrifice is the opportunity

of the exchange dealer, who will send money to Chicago, and put himself in funds there, and so be able to supply money in Chicago to any one in New York who will pay for it at the rate of one dollar and one cent plus any profit that the exchange dealer can squeeze out of him.

Viewed in this simple example the problem of exchange has few terrors. It is merely a question of the price of money in one place, as expressed in the same money in another, with fluctuations governed by supply and demand and limited by the cost of sending money from place to place. This limitation does not mean that supply and demand cease to govern the market, but merely that at a point supply can be increased to meet any demand by the despatch of currency.

When we go back to the question of Foreign Exchange there are several complications to be considered. If practice would only be kind enough to conform to theory, these complications would be merely superficial and easily calculable items, as long as the exchanges under discussion were between two countries with gold standards. In theory, we should only have to allow for the difference in weight and fineness between the standard gold coins of the two countries, and the

length of time that it takes to send the metal from one to the other—so that we might add the loss of interest during this period to the cost of shipment—and we should then have reduced the problem to the simplicity of our American example, and find the fluctuations in exchange limited by the same influence, namely the cost of sending gold from one centre to the other. In theory, the exact gold equivalent of an English sovereign is 25 francs 22 centimes and the cost of shipping is about 8 centimes, so that if the price of English money rose above 25 francs 30 centimes in Paris, the exchange dealers would immediately ship gold to London, and sell in Paris the English money which they would get for their gold. So the Paris cheque could not rise above 25 francs 30 centimes plus the minute fraction that the exchange dealers could extract as their profit. It is often assumed by economic writers that this is actually the case, and we generally find them laying down a law that the cost of sending gold from one gold-using centre to another results in the establishment of what are called gold points, above and below which the rates of exchange cannot rise or fall.

In actual practice, however, the working of the

foreign exchanges is not attended with this sweet simplicity. In fact, the theoretical gold point is only the point at which it pays better to send gold than buy a bill, if you can get the gold. And it has already been shown that England is the only country in which the possession of a claim to a certain amount of money carries with it the certainty of immediately turning it into gold. And so we find that it is quite possible for the exchange on London to rise in other centres to a point at which it would be much cheaper for those who have payments in London to send gold instead of buying drafts, without any gold coming to London, because no gold is to be got. For instance, the mint par, as it is called, between Germany and England is, according to a table drawn up by Mr. George Clare,* the well-known expert in exchange, 20 marks 43 pfennigs, that is, this is the point at which the gold in the German coin is exactly equivalent to the gold in the sovereign; and the expense of sending gold to London is calculated at about 5 pfennigs; so that the point at which it pays to send gold to London is theoretically 20 marks 48 pfennigs. But in November, 1912,

* His "A B C of the Foreign Exchanges" should be studied by all who wish to master the technical intricacies of exchange.

the Berlin exchange stood for some weeks at or above 20 marks 53 pfennigs without any gold being shipped to London, and in 1907 the Berlin exchange touched 20 marks 60 pfennigs. According to theory, in November, 1912, London ought to have been drawing gold freely from Austria and Russia also, but not a shillingsworth arrived. The *Statist* of November 16 made the following observations :—

"As a matter of course, the exchanges continue to be as unfavourable to Germany, Austria-Hungary, and Russia as they have been for a considerable time now. And equally as a matter of course, gold is not withdrawn from the State banks and shipped abroad. . . . All this shows what remarkable power the State banks exercise each in its own country. And it shows, likewise, how very inadequate is the treatment of financial subjects by economists in general. If men always acted in accordance with their pecuniary interests gold would be pouring out from Russia, Germany, and Austria-Hungary at present. But the Governments of the three States have set their faces against such exports. The State banks in each case support the policy of the Government, and the subjects are all afraid to incur the displeasure of the great Governments and powerful institutions.

What is still more to the point, foreign bankers and merchants do not dare to take gold from any of the three States. They, likewise, could make a profit if they knew how to get the gold out of the State banks. But either they are incapable of inventing any method that would force the banks to give the metal, or they are in too much dread of the Governments to incur their displeasure."

Thus it appears that the theoretical doctrine, which lays it down that the rates of exchange cannot move beyond the point at which it pays better to ship gold than buy a draft, is only borne out where there is a free market in gold, and a claim for money carries with it an unquestionable right to immediate payment in gold. And these conditions exist only in England. As a bill broker once ruefully remarked at a time of international monetary stress, "These confounded exchanges only seem to work the wrong way. When they go against us, we lose gold. When they go in our favour, we don't get an ounce of it." This is certainly a true statement of the facts of the case, as they sometimes happen. When the foreign exchanges move against us down to gold point gold leaves London as a matter of course. When the exchanges move in our favour up to gold point,

it is quite possible that no gold will come, and that unfortunate foreign merchants who have payments to make in London will have to pay a steadily rising premium in order to buy English money. Ultimately this state of things will correct itself, because anyone who can procure English money by selling goods, services or securities to England, or by raising credits in England, will be encouraged to do so as fast as he can, so as to secure the high price that is current for English money in his home market. And at the same time the depreciation of the foreign money will act as a check on English traders and cause less English goods to be sent to the country thus afflicted. So the supply of English money will be increased and the demand for it will be lessened.

Countries with a semi-gold standard, like Brazil and India, which will take gold and issue currency against it, but do not even pretend to be ready to turn currency into gold, are officially committed to the maintenance of their currencies at or near a certain exchange level. Both in Brazil and India this level is 16*d.*, in the former for the milreis, in the latter for the rupee. When India or Brazil owes so much on balance to England that the demand there for English money becomes so keen

that a rupee or a milreis will no longer exchange for 1*s.* 4*d.*, the Government meets the position and steadies the exchange. This it does by offering money in London, either drawing on its balance there or borrowing there in order to create a fund to draw on. It thus creates a supply in India or Brazil of money in London in order to restore the balance of demand and supply to which we thus come back, as the chief factor in determining rates of exchange. For in the exchange market, just as in any other, the question how the supply is produced is not a practical one for the moment.

Just as in the stock markets an offer of stock by a bear seller, who will have to buy it back again some day, has just the same effect, for the time being, on the price of a security as the offer by a real seller who has his stock to deliver, so rates of exchange are affected just as much by the offer of money in another centre which is borrowed for this purpose, as by that of money which is genuinely owing through trade transactions. In fact, we shall see as we go further into this subject that the creation of claims for money in other countries through credit operation is a very important item in the total of exchange transactions.

Critics of India's present currency arrangements

sometimes deplore the fact that the exchange has to be regulated by Government and cry out for a gold standard or a gold currency, on the ground that then the exchange would be automatic and regulate itself. But this is not so. No country can afford to leave its exchange unregulated. We shall see later that the Bank of England is always watching the foreign exchanges, and when it sees fit, takes control of the money market in order to regulate them. Among the countries that are prominent in international trade and finance the only one that leaves its exchange to its own devices is America, and the results of its neglect rouse astonishment rather than envy among other nations, and make the American business world clamour continually for a regulating body.

In the case of the few silver-using countries the rate of exchange will, of course, be influenced by fluctuations in the relative value of silver and gold. When the price of silver rises the price of the Shanghai tael, as measured in sovereigns, will also rise. Supply and demand are still the chief influence, but the demand for a claim for so much silver will obviously increase if the selling price of the silver in the bullion markets of the world goes up. This adjustment being made, rates of

exchange will fluctuate on the same principles as those between gold-using countries. But it need hardly be said that the necessity for continually making this adjustment between the relative values of the two metals is a serious bar to trade, and to some extent turns commerce with a silver-using country into a gamble in the price of silver. A merchant who is shipping cotton goods to China has to allow for the chance of a serious fall in the gold price of the money that they will fetch, beyond and besides all the "slings and arrows of outrageous fortune" to which exporters of goods to far-off lands are exposed. Usually, however, he passes the risk on to his bankers, by selling them bills drawn against the shipment; and the bankers of course make a charge for the risk that they take, in the price that they pay for the bills.

When it is a question of mere paper, we begin to see the great advantage that is conferred by the apparently barbarous dependence of the economically civilized world on the supply of a metal for the basis of its currency. When there is no such basis, and the amount of a country's money is regulated solely by the extent to which its Government will print promises to pay, enormous fluctuations become a normal feature in the rate of

exchange, the general tendency being towards a rapid fall in the value of the currency owing to the strong inducement put before the Government to pay its way by printing more promises to pay. In some cases, countries have gone on printing them so persistently, that their promises were finally not worth as much as it cost to print them.

The almost inevitable consequences are a disorganized trade, a demoralized credit and inflation and speculation, usually accompanied by corruption, and generally culminating in bankruptcy. It need not be so necessarily, and the bad effects that usually follow the use and abuse of paper currencies, with no attempt at metallic backing behind them, may be largely ascribed to the fact that they have only been adopted by countries in a very backward state of development. Under proper restrictions and regulations, and in the hands of an ideally wise Government, it is possible that purely paper money might work well enough, but it would have to be handled with extraordinary skill and foresight, for anything like muddle or mistake would mean disaster.

Moreover, any nation that made an experiment with a purely paper currency, though it would thereby effect an enormous economy, would at

the same time cut itself off from all chance of supremacy in international banking business, which, as things are at present arranged in currency matters, depends to a great extent on the degree of certainty with which a country's money can be turned into gold at the option of the holder. This is the great advantage given to us by our English system, under which all our money either is gold or can be turned into gold. It is a great cause of our supremacy as international bankers, and is one of the reasons why the bill on London may be called the currency of international commerce, and why a claim to money in London is a more popular form of credit than a claim to money anywhere else, and so why the London bankers and other wheels in the monetary machine are always making big profits by accepting bills and discounting them. The system has its drawbacks, and our traders and manufacturers often growl about the big and many movements in the rate of interest here as compared with that ruling in France, where there is no obligation to meet claims in gold. But the wealth that is poured into England by our accepting and discounting business seems to be a sufficient answer to these complaints.

The second great cause of our supremacy in international banking is our supremacy in international trade. In spite of all that has been said of late years about the decay of our industries and the big slices that our rivals are always said to be cutting out of our commerce, this little country, with a population half that of the United States and two-thirds of that of Germany, still has the biggest trade turnover in the world. This is another reason that makes a claim to money in London a form of credit that is everywhere popular and easy to dispose of, because London holds the whole world in fee for goods exported, services rendered, and interest on loans, and so all the countries of the world have payments to make in London, and a bill on London is thus more easy to sell than a bill on a country with a less widely distributed trade. But this mention of the interchange of goods and services between nations, and its effect on the problem of exchange, brings us to the very big subject which will be dealt with in the next chapter.

CHAPTER III

TRADE AND SERVICES

FOREIGN exchange being the business of international money-changing, that is, the buying and selling in one country of claims for money in another, we have next to see how these claims come into being.

Claims for money between one nation and another arise in exactly the same way as claims for money between one person and another, but they are much more complicated and much more difficult to trace and express in figures. They are more complicated, because in any given pair of nations trading together there may be scores of people buying and selling the same sort of articles across the sea or across the frontier. In ordinary private dealings the doctor sells medical advice and buys beef: the butcher sells beef and buys medical advice; but England both buys boots from

France and sells boots to France, and so with dozens of other kinds of goods. This complication is not at all a serious matter as long as we always remember to allow for it; but the difficulty of tracing the exchange of goods and services between nations is one of the problems that make the subject of Foreign Exchange a fascinating inquiry, because there is always an element of mystery and elusiveness about it that can never be reduced to the humdrum dullness of a definite statement.

In the case of an individual, who is careful and business-like enough to keep exact accounts of his outlay, it is easy to see at a glance how he stands in the matter of getting and spending, which are his equivalents of exports and imports. He exports the services that he renders to his fellow citizens whether as soldier, sailor, tinker, tailor, or Member of Parliament, taking payment in cheques, notes or coin; or if he is living on saved or inherited wealth, he exports claims based on his own previous services, or those of his ancestors, rendered in the past. He imports shelter, food, clothes, transport, medical advice, legal advice, amusements, dissipations, golf clubs and all the other necessaries and embellishments

of life, pays for them in coin and cheques, and at the end of the year his banker's pass-book and his own account books, balanced against one another, show him exactly what he has received, how he has spent it, how much he has saved or how far he has outrun the constable.

With a nation it is otherwise. It cannot possibly keep full accounts of its income and outlay. It can give a record of the value of the actual goods that come in and go out across its frontiers, but it cannot show that of the intangible services that it buys and sells abroad. Its case is like that of an individual who kept the bills of his tradesmen who deposited goods at his door, but had no record of anything that he bought—such as the use of a seat at a theatre—that could not be seen entering his house, or of anything that he sold —such as legal advice or professional entertainment —that could not be counted and valued as it went out of his door. Hence it is that the most carefully compiled figures of a nation's income and outlay always leave a wide space, in which the fancy of those who try to fill it in may roam at large, indulging in all the alluring luxury of estimated statistics, constructed to suit the most cherished theories of the inquirer.

To avoid confusion, it is perhaps better to point out that when I speak of the nation's accounts of its income and outlay, I do not mean the Government. The Government does publish accounts which are alleged to be a full statement of its receipts and expenses, and a fine confused medley they are. What I mean by the nation's income and outlay is the amount that it annually has to receive from and pay to other nations, for this is the most important cause of fluctuations in the rates of foreign exchange, being evidently the influence which largely determines the demand for and supply of English money, or claims on England, in foreign countries.

For enlightenment on this subject, we have no lamps to guide us with more than a hazardous glimmer, except in what are called the Board of Trade Returns, published monthly, which give us the figures of our imports and exports of goods and bullion. These are, probably, fairly accurate as far as they go. They are certainly as accurate as the Board of Trade can make them, but the Board of Trade has to depend on the statements of shippers and, for obvious reasons, it cannot include the goods which are brought in by amateur and professional smugglers. In any case these returns

do not, by any means, cover the whole of the ground but leave a very big gap, since they always show that the value of our imports is very much greater than that of our exports. In 1912 the figures were as follows :—

Net Imports (including bullion)	702 millions
„ Exports „ „	552 „
„ Excess of imports	150 „

Now this huge excess of imports, which is much bigger in the case of England than in that of any other country, is often very terrifying to people who have not thought much about the subject, when it is first put before them. It is commonly called an adverse balance of trade, a phrase which has an uncomfortable sound, as if there were something chronically rotten in the state of our commerce, and it is sometimes used as a proof, by economic Hotspurs who leap to hasty conclusions, that other countries are continually pouring goods into us and taking nothing from us in return, and that this is a state of things which ought immediately to be stopped, in the interests of the national welfare. If this were true—that other nations pour goods into us and take nothing in return—it would seem, on consideration, to be rather a comfortable state of

affairs. Any individual who could arrange his commercial relations with his fellows on these lines would be likely to grow very fat. To be always consuming more than he produced, is just the sort of life that would have been found thoroughly pleasant by the Economic Man, as conceived by the older economists. And, in the case of a nation likewise, the process, if it were really possible, would seem to tend to the enjoyment of much plenty with little effort, though in its case it would be very important to make sure that the goods poured in for nothing were fairly distributed and went into the right hands.

But, in fact, these things do not happen. The other countries of the world have not conspired together to kill England with kindness and give us 150 million pounds' worth of goods every year for nothing. Goods are never sent anywhere unless there is reasonable certainty that the country to which they are sent will be able to pay for them, in meal or in malt, in goods or in services. The foreign seller of the goods expects to be paid in the money of the country, which he will turn into that of his own country by selling his claim through the machinery of exchange. But if the importing country were

really always buying more than it sold, the supply of claims on it would be continually greater than the demand for them and the exchanges would go steadily against it, and either it would have to export gold, or export promises to pay as long as it could finance itself on Mr. Micawber's principles, or allow its currency to be so depreciated in relation to that of other countries, that merchants abroad would finally give up selling to it.

Now it is certain that we are not exporting gold. Year in and year out we import rather more than we export, as the Board of Trade Returns show. Against this we have to set the sovereigns that the travelling Briton takes with him in his pocket when he goes to the Continent and leaves behind there in return for services rendered by his foreign entertainers; but owing to the great facilities now offered by bankers and travel agencies in the shape of circular notes that can be cashed in any foreign centre, this invisible export of gold is probably in these days a comparatively small matter, and is easily offset by the large blocks of imported gold shown by the published figures.

It is also certain, though we cannot show definite figures on the subject, that we are not

on balance exporting promises to pay, our own or other people's. If they were our own we should be raising loans abroad, which we are not, or other nations would be investing in our securities, which they do to a small extent, an extent quite tiny when compared with the pace at which we invest in the securities of other countries. If we were exporting other people's promises to pay, it would mean that we were selling to foreigners out of our huge holding of foreign securities, more foreign securities than we were buying from foreigners. Now this may sometimes be so, for the facilities of dealing offered by the London Stock Exchange bring a great deal of foreign business to it, and at times when Americans are buying their railroad stocks and bonds in London, and Germany is buying Canadian and American shares, and France is indulging its fancy for our South African shares and oil shares and copper shares and rubber shares, it may sometimes happen that the tide of buying is flowing into England and that we are exporting securities on balance. But this could not happen continually without affecting the figures of income tax collection from interest on foreign securities, which, as far as they

can be trusted, show that on balance and on the average our national income from foreign securities held here grows steadily and rapidly.

Moreover, we still have to put into the account the large number of new foreign and colonial securities—Government loans, municipal loans, railway and industrial stocks and bonds—that are continually brought out in London and are in fact imports of promises to pay. On the whole it may very safely be asserted that we continually invest abroad an enormously larger amount than foreigners invest here. Sir George Paish, the editor of the *Statist*, who has made a special study of this question of the amount of our foreign and colonial investments, calculates that we are increasing them at the rate of about 160 millions a year.

Nor do rates of exchange move steadily against us, as they must if we were really leading the profligate life of commercial dissipation that a hasty glance at the Board of Trade Returns might lead the unwary to infer. The course of exchange moves along a quite normal level, and has in fact in recent years been on the whole rather more favourable to us than it used to be.

It is thus clear that the big gap between our recorded exports and imports of goods and metals is filled by unrecorded, and so usually called "invisible," exports of various kinds of services, and that there is no need to be frightened about it. If, for example, an English insurance company insures a French factory against fire, it thus creates an English claim on France for fire premiums, which is just as valid in balancing the account between the two countries as if it had been selling boots or any other visible goods that could be recorded in the Board of Trade Returns. We shall be still less frightened perhaps about our adverse trade balance when we recognize that it is a quite common complaint among nations, and that most of them habitually import more than they export, according to the trade figures which they publish.

In 1903 our Board of Trade brought out a Blue Book (Cd. 1761) on British and Foreign Trade and Industry, a few pages of which, 99 to 105, discuss this question of the excess of imports into the United Kingdom. It gives a table showing for 1891, 1896, and 1901 the aggregate imports into and exports from all the principal countries of the world.

	Imports, Million £	Exports, Million £	Excess of Imports
1891 ...	2099 ...	1850 ...	249
1896 ...	2147 ...	1898 ...	249
1901 ...	2516 ...	2292 ...	224

In 1901 the English excess of imports was 180 millions, so that when we deduct this from the aggregate excess in that year it leaves the comparatively small amount of 44 millions for all the other principal countries of the world on balance. Still, there is the fact that the aggregate of recorded trade shows an excess of imports to be the average experience.

The Board of Trade Blue Book accounted for this curious fact in a very ingenious manner. "Since," it says, "the imports and exports of the whole world are, for the most part, the same goods valued at the point of arrival and departure respectively ['the United States and a few other countries form exceptions to this statement,' it adds in a footnote, 'but this is not sufficient to affect the calculation seriously'], the excess of value of the imports should give a rough measure of the difference of valuation due to the cost of ocean carriage, including freight, insurance and all other charges." And it proceeds to the conclusion that since British ships do about one-half

of the ocean carrying trade of the world, half the aggregate excess of imports of the principal nations is its gross profit on the transaction. From the sum so arrived at, 112 millions, it deducts the earnings of colonial ships, and sums spent abroad by our shipping companies out of earnings, arriving finally at about 90 millions for the gross earnings of the mercantile fleet of the United Kingdom.

There are obvious difficulties in the way of accepting this conclusion as anywhere near the mark, and the Board of Trade made no claim to any close approach to precision. A large part of the world's trade goes from one country to another in goods trains. When they go across one frontier only and are valued at it both as exports and imports they do not upset the calculation. When they cross several frontiers, they do. Moreover, the Board of Trade was only able to include the "principal" countries in its aggregate, and in this qualification there is room for plenty of leakage. But whatever the figure may be, the freight charges paid to us by foreigners are a big invisible export, and go a long way towards accounting for the visible excess of our imports of goods.

Besides this question of transport charges,

whether by sea or rail or caravan, which is an invisible and incalculable item in the trade balance of every country that imports and exports, there is an equally important and elusive factor in the shape of the import and export of securities and of interest on capital. Almost every country in the world is either a lender or a borrower. The borrower exports securities, or promises to pay, and takes in return the goods and services that it requires. Later on, when interest payments fall due, the lender has coupons * to export, and the borrower has to ship goods to meet them. When Russia raises a loan in France, it exports its bonds or promises to pay, and sells them to the thrifty French investors. Thereafter French investors export coupons every half-year to Russia representing claims to interest due. Thus the exportation of securities and the subsequent exportation of coupons by the lender both tend to

* Coupons are pieces that are cut off bonds and other securities "to bearer." They represent a claim to so much interest, usually for a half-year, and when presented to the borrower's agent, and found to be genuine and in order, are thereupon cashed. I use coupons throughout to express claims for interest, because they are a tangible token, and so can more easily be thought of as an export. In the case of registered securities, no coupon is presented, but interest is sent by post to the registered holder ; nevertheless, his claim for interest is none the less an export.

produce the same result, a balance of visible imports.

Consequently we find that this adverse balance —or excess of visible imports—is a feature in the trade figures, both of the young and go-ahead countries that are habitual borrowers and are always exporting securities, and of the old-established nations that have plenty of accumulated capital to spare and have placed blocks of it abroad, and so always have plenty of coupons to export. In both these cases there is an invisible export, in one case of securities, in the other of coupons, which usually has to be met by visible imports of goods, which thus create a so-called adverse trade balance. The so-called favourable trade balance, under which a country shows more goods going out than coming in, is chiefly shown by those nations which have reached the stage of being in a position to pay interest on borrowed capital, or part of it, out of their own productions, without having to borrow more from their creditors in order to meet interest.

Let us see how this complicated business works in the case of Canada, now perhaps the most notable example of a young and go-ahead country that is developing itself as fast as it can,

and raising capital abroad to do so by the export of securities. Canada is building railways, docks, harbours, towns and factories, irrigating its land, clearing its forests and otherwise harnessing itself to be a great producing country. It has not within its own borders nearly enough accumulated capital to carry on all this development, and does not produce enough goods to supply the wants of its population and at the same time provide all the materials needed in its up-building process. So it continually borrows money abroad, especially in England, either by raising Government loans or municipal loans in the London market, or by selling to English investors bonds and shares of its railways and land companies and timber companies and iron and steel companies. It thus exports securities to the lending country, which in turn exports to it coupons, or claims for interest and dividends as they fall due. With the credits raised by its export of securities, Canada meets these coupons, pays what it owes for freights and other services, and finally pays for the goods that it has still to import in excess of the value of its exports. It is interesting to note the fact, lately pointed out to me by Dr. James Bonar, Deputy Master of the Canadian mint, that Canada, though she borrows

chiefly from England, does not import from England more goods than she exports thither. Her excess of imports comes from the United States, and Canada pays for them with bills drawn on London against securities exported to England. This is the case of a country that is year by year exporting securities to an amount larger than that of the coupons that it has to meet, and so takes in an excess of visible imports of goods, since securities are usually paid for chiefly in that form, though a certain amount is sometimes expressed in metal. Among other countries that are at this developing, security-exporting stage are Japan, Russia, and Mexico.

The United States is an example of a country that is still developing rapidly and exporting securities to raise capital for its development, but has already arrived at a stage of productive activity at which it is able to ship goods which have value enough to meet the coupons on most of the big blocks of securities that it has exported in the past. It does not perhaps send goods enough to meet the whole of this charge, certainly not to cover the whole amount that the United States has to pay for the manifold services that it buys, as we shall see, from England and

Europe. It need not do so, because its export of securities, which is still taking place, is a set-off against these charges and goes part of the way towards balancing the account. In this case there is an excess of exports, goods being sent to meet the import of coupons less the amount of securities still being exported. Other countries that are at this stage of their economic history are Argentina, Brazil, India, and the Australasian Colonies.

Finally, we come to the old countries which have been in business for a long time, and have long ago built nearly all the railways and towns that they require, and done all that is to be done in the way of clearing their land for agriculture, and have, moreover, accumulated a big store of capital that is more than enough to supply such development work as their more or less jog-trot progress demands, and so are very ready to go abroad to seek fresh investments at the high rates of interest and profit that the hungry, young, go-ahead countries can offer. In so far as they are actually importing securities at the moment, they would probably have, on this account, an excess of exports, because part of the credits that they so grant will generally be used by the countries whose securities they buy to purchase commodities,

though they might be spent on freights, commissions, and other invisible services.

It does not follow that the goods or services are actually bought by the borrowing country from the lender, but an import of securities ultimately results in an export of goods or services by the lending country. For instance, if we lend money to Argentina, and so import its securities, it may be that Argentina will spend the credit that we so give her by buying railway material in Belgium or Germany. This process will transfer the credit that we have given to Argentina to the Continental country, and it will use it either for the purchase of our goods or services or to pay debts to other countries which want money in London because they are buying goods or services from us. However long and twisted the chain may be that connects the import of securities with the export of goods or services, its pull will finally tell, since those who borrow money take it in some form or other, or hand over the right to take it to some one else. Since we do not export gold on balance it follows that goods or services must be taken from us.

The actual import of securities, then, should tend to produce an excess of exports, just as we saw in

the case of Canada that the export of securities produced an excess of imports; and in the first half of the nineteenth century an excess of exports was a regular feature in English trade. But in the case of those countries that are old stagers in money-lending, this influence is easily off-set by the effect of the export of coupons, representing claims for interest on the sums that they have invested abroad in former years. No definite figures are to be had to show us either the value of the securities that we import year by year, or that of the coupons that we export. But Sir George Paish, who has already been quoted on this subject, estimates that we have invested abroad some 3500 millions, and that we are now importing securities at the rate of more than 160 millions a year. If we accept the figures of this careful and exceptionally well-equipped inquirer, and adopt his theory that our investments abroad yield us an average rate of 5·2 per cent., we should expect to receive from other countries some 182 millions a year against coupons exported, as a set-off against the 160 odd millions a year that we pay against securities imported. If this be so, there would be a balance of about 20 millions a year to be provided by the borrowing countries,

which they meet by pouring goods into us. In other words we make an invisible export of coupons and dividend warrants, to balance which the borrowers make visible shipments of goods, which are recorded in our trade returns.

Countries in a similar position to ours in this matter of receiving goods in payment of interest on old investments, partially off-set by a contra-entry on account of fresh investments that they are now making, are France, Germany, Holland, Belgium, and Switzerland. France, with its thrifty citizens, is a very big investor every year, and the interest on its accumulated savings placed abroad is always rolling in in the shape of goods from the debtor countries. In the case of Germany, a large part of its so-called adverse trade balance is probably due, as in ours, to the earnings of its merchant navy. There is good reason to doubt whether Germany, which is still at a stage of rapid development, has yet any considerable surplus of its own to invest in other countries' enterprises. It does certainly take part to some extent in international finance, but it does so largely with other people's money, taking skilful advantage of the facilities given it by the Paris and London loan and discount markets, financing itself

there cheaply with temporary loans continually renewed, and financing other people with the proceeds at a pleasant profit to itself. But it is usually included among the nations which invest abroad, and whether it does so with its own money or other people's is a question that cannot be decided.

We have seen, then, that this question of investment abroad and importing securities, divides the nations into three groups :—

(1) The young growing nations export new securities to a greater extent than they import coupons, and so have an adverse balance of trade, since the goods that come in in payment for securities are greater in value than those which go out in payment for coupons. This stage is always rather a dangerous one, for if, owing to war or war scare or any shock to credit that makes men inclined to keep their money in hand, the lending nations suddenly button up their pockets, countries in this position are likely to be hard put to it to meet the coupons that are presented to them. And as long as borrowing is easy, these young nations, seeing their own future in the rosiest of lights, are naturally tempted to go rather too fast in mortgaging the productive power that they hope to have some day.

(2) The further developed nations import coupons faster than they export securities, and so have what is called a favourable balance of trade, because they meet their interest charges by sending out goods.

(3) The still further developed nations export coupons faster than they import securities and so have an adverse balance of trade or an excess of visible imports, because goods are sent to them to meet the coupons that they present. It has been shown, for example, that England is estimated to be owed about one hundred and eighty millions a year by its debtors abroad, so that, though it imports new securities to the extent of some one hundred and sixty millions, it still has twenty million pounds' worth of goods to receive without making any visible exports against them.

Putting the matter in diagrams and simplifying it by leaving out all invisible articles of export except securities and coupons, we can strike trade balance sheets for the three classes as follows:—

(1)

Imports.		Exports.	
Goods ...	£50,000,000	Goods ...	£40,000,000
Coupons ...	5,000,000	Securities ...	15,000,000
	£55,000,000		£55,000,000

Excess of visible imports, £10,000,000.

(2)

Imports.			Exports.		
Goods	...	£40,000,000	Goods	...	£45,000,000
Coupons	...	10,000,000	Securities	...	5,000,000
		£50,000,000			£50,000,000

Excess of visible exports, £5,000,000.

(3)

Imports.			Exports.		
Goods	...	£50,000,000	Goods	...	£45,000,000
Securities	...	10,000,000	Coupons	...	15,000,000
		£60,000,000			£60,000,000

Excess of visible imports, £5,000,000.

CHAPTER IV

INTERNATIONAL PAYMENTS

In the last chapter we seemed to be wandering far from the subject of Foreign Exchange when we discussed the question of the invisible services and interchange of securities and coupons, that help to fill the gap that is left between the visible imports and exports of most countries. But this problem is very much to our point, since it is the relation between imports and exports, of every kind, that is the main cause of the fluctuations in the supply of and the demand for the money of one country in another, and so of the movements in rates of exchange.

If we leave out the rest of the world for a moment and look at the trade relations of France and England only, we see that every sale of goods that England makes, or every form of service that it renders to France, makes some one in France want money in England to pay for it; and every

sale and every service that France can place to England's debit means that some one in France thereby has money in England owed to him that he can offer to the dealers in exchange in Paris. Consequently, every export that England makes to France tends to turn the exchange in our favour, because it makes a demand in Paris for English pounds and raises the amount in francs that will be paid for them, and every import that we make tends to turn the exchange against us, because it means that so much English money is offered in Paris tending to depress its price in francs.

When an English wine merchant buys £10,000 worth of champagne, the French exporter has English money due to him, which he wants to convert into francs. He has a bill on London to sell, and his sale of it will tend to depress the price in francs of English currency. This is an import of the obvious and visible kind which is recorded in the trade returns. The effect is exactly the same if a thousand English tourists have spent £10 each in the course of a visit to France, or if a thousand French investors have been paid a dividend of £10 each by an English rubber company. These are invisible imports by England, since in one case the tourists have imported the

pleasure and recreation alleged to be produced by a journey on the Continent, in the other the English rubber company is importing the coupons representing its foreign shareholders' claim to a share in its profits. In both cases the operation has created a claim on England, the sale of which tends to lower the price of the English sovereign as expressed in francs.

On the other side of the account we may take English exports of hardware to France as an example of visible exports, while among our invisible exports across the Channel we can number freight and insurance charges on goods that we carry for France in our ships, the profits of our insurance companies, which do a large business in fire and other risks in almost every country in the world, commissions earned by our bankers, stock brokers, produce brokers and metal brokers on French orders, interest on English money invested in French enterprise, claims due on account of the French tourists who come to England, and so on.

All these exchanges of goods and services that influence the relative price of English and French money are more or less real, though in the case of the invisible ones—those not recorded in the trade

returns—it is not possible to trace their volume in definite figures, and so a study of the movements in exchange has something of the glorious uncertainty of cricket, because inquirers have to work on data which are bound to be, to a certain extent, hazy and hazardous. But in the cases that we have so far considered there is a genuine payment due for a commodity or security bought or a service rendered or for interest on an investment.

There is yet another influence on exchange, however, which has not this quality of a real transaction behind it, but has a very important effect on rates, and in some ways is the most important of all, because it is through it that those whose task it is to regulate the money markets of the world have to work when they want to influence the exchanges. This influence is the temporary transfer of money from one centre to another to take advantage of a higher rate of interest. For instance, if we suppose that 5 per cent. is being paid for short loans in Berlin and the London rate for similar loans is only 3, it is evident that there is a temptation for English moneylenders to send funds over to Berlin to be employed at the higher rate. This they would do

by instructing their German correspondents to draw on them, so creating a fictitious German claim on England, which has just the same effect on the exchange market as a claim produced by a genuine transfer of goods or services. The German house draws a bill on the English lender, probably payable at two or three months' sight, and so has a claim on England to sell in the exchange market in Berlin. Having sold the bill it has the proceeds in hand to lend out in Berlin.

Thus a high rate of interest current in any centre has the effect of creating fictitious claims for it in other countries and so turns the exchange in its favour, and this is why the Bank of England often has to take measures to produce scarcity of money and a high rate of interest and discount in London, in order to turn the foreign exchanges in our favour, when they are moving in a threatening manner towards the point at which exports of gold become the most profitable form of remittance. In this case, however, the matter is complicated by the fact that these creations of claims in order to take advantage of a high rate of interest not only influence the exchange, but are influenced by it. There is not often such a fine margin to be got as the difference between

3 and 5 per cent. and even if there were the question of exchange would have to be considered.

It must be remembered that the English lender of money in Berlin has to buy marks at the beginning of the operation and sell them at the end. Consequently, the English lender will lose his profit on his transaction if he buys his marks at too low a rate and sells them too high when he wants to bring back his money. So that a big margin between the rates of interest current in one centre and another is not enough to bring money from one to the other, unless the rate at which the currency of the lending side can be turned into that of the borrower offers a reasonable chance to those who propose to send funds across by telling their correspondents to draw on them.

This question of the variation in rates of exchange is in fact so important an influence on the transfer of money from one centre to another, that when the price of English money is high in Paris, French houses which have balances in London are tempted to sell it, and English firms are tempted to tell their correspondents in France to draw on them, merely on the expectation of being able to cover themselves later at a more

profitable rate. When the price of English pounds goes up to 25 francs 28 centimes, or thereabouts—owing perhaps to some pressure for remittances from Paris to London due to heavy French subscriptions to an attractive bond issue that is being brought out in London—and there is reason to expect that, in the ordinary course of trade and other transfers, it will fall several centimes when this special demand has passed, claims on London are created in this fictitious manner in order to make a profit out of the fluctuation in exchange.

In the case of America, which has large amounts of money to claim in England and Europe in the autumn, when cotton and cereals are being shipped and sold abroad, and at other times in the year usually has remittances to make on balance to meet the coupons that the old countries ship to it, and the large sums spent by American travellers, the course of exchange is subject to big regular fluctuations like the ebb and flow of a tide. Normally the exchange is in favour of America during the last five months of the year, and against it in the first seven. This tidal ebb and flow may of course be disturbed by stock market activities, which may cause big shipments of securities from one shore of the Atlantic to the other; but at least

it is regular enough to have brought into being the practice of creating claims by America on Europe, and the sale of them at the high exchange ruling in the early part of the year. The dealers in exchange who do so know that in all probability they will be able to cover themselves at a profit later by buying the produce bills that flood the exchange market during the autumn and force down the price of claims on Europe in New York.

It sometimes happens that those who thus gamble in futures in the exchange market and sell claims on Europe in the expectation of a great increase in the supply and a consequent fall in their price are caught and squeezed, as may happen to the bears of any other commodity; but they are usually quite strong enough to stand a little squeezing, and in the meantime their sale of fictitious exchange when it is wanted, and their purchases of real exchange when it is over-plentiful, help to modify the fluctuations of the market in a manner that is useful and beneficial to the producer and consumer of claims on Europe.

The most important influences which provide claims in one country on the money of another, and so produce activity in the exchange market,

have now been enumerated. Looking back over them we see that they are the interchange of goods, and payments for the cost of their transport from the producer to the consumer, imports and exports of securities, and of the coupons which represent claims to interest on securities imported and exported in former years, and the temporary shifting of capital from country to country to take advantage of favourable rates of interest or favourable rates of exchange. These are the biggest streams that feed the broad river of the exchange market, but there are many other streamlets which flow into it, and have a considerable effect at certain seasons.

Travellers' payments form one. Every John Bull who goes forth with his Baedeker to widen his mental horizon on the Continent carries with him a wallet stuffed with circular notes and a few good English sovereigns, for he is proud of the fact that all foreigners are glad to see the characteristic coin of his country. In so far as he carries coin he is conducting a bullion movement, and draining England of its gold to pay for the alleged beefsteaks that he consumes under other skies. His circular notes, however, with which he finances most of his expenses, supply him with

local currency at the expense of balances, or credit arrangements, kept or made for this purpose by his bank at home which supplied him with the notes. These balances have to be replenished as John Bull draws on them, and so his bank has to remit to its correspondents. In other words, every franc, mark, or lira that Englishmen spend on their travels creates a claim on England that comes into the exchange market, and tends to depress the price of claims on England; in other words, to turn the exchanges against London.

In so far as he pays his way, as he often does, with cheques on his London bank, he is himself producing claims on London, which finally come home to him by way of the foreign exchange dealers, generally after many months, and with a string of endorsements on the back of them, which show that they have been acting as a medium of many purchases and sales in the country in which he shed them. But in what way soever it is financed, foreign travel is an import by the country of the traveller, and like all imports tends to turn the exchanges against it by producing claims on its money.

Brokers' commissions are also a good-sized item in the account. English agents do a big business

day by day for foreigners in our stock markets and produce markets and metal markets and in placing insurance risks. It is an interesting fact that in most years we apparently export silver to a greater value than we import. It might be inferred that we produce silver from our own mines. Perhaps in about a hundred years' time a theoretical statistician will arrive at this conclusion and draw interesting and ingenious deductions from it concerning the activity of silver-mining in England. What happens is that our metal brokers add their commissions to the total of the exports.

Another streamlet that sometimes swells into a respectable torrent is made by the many drops poured in by poor immigrants into new countries, who go there to seek the higher wages that the scarcity of hands there produces, and send home to their kinsmen such small sums as they can spare, which come to a big total year by year. On account both of travellers' expenses and workers' remittances, Italy is believed to score heavily. Italy is always crowded with travelling foreigners, pouring out claims on the money of their several countries, and in North and South America and in England the thrifty, hard-working Italian is everywhere to be found earning wages as waiter, barber,

organ-grinder, ice-cream seller, and above all as road-maker, railway-builder, and mason. For the Italians seem to have inherited this gift of skill in masonry from their Roman ancestors, and especially in the United States wherever there is a big contracting job there will be a colony of Italian dagoes, as they are called, taking part in the work. They seem to take with them the home-grown power of living largely on sunshine and good humour, and the sums that they send home are an important cause of the power shown by Italy to maintain a so-called adverse trade balance, without the assistance of investments abroad or the profits of a big carrying trade.

Ireland is another country that takes toll of the rest of the world through the filial piety of her sons who have gone abroad to seek their fortunes in lands where thews and sinews find a better market than at home, and Scandinavia, Germany, and Great Britain, and all other countries which export sturdy workers, thereby tend to turn the exchanges in their favour by so doing. The drain is not all in one direction, however, for the emigrants generally take a little money with them when they go, and are not allowed to enter the United States unless they do so. Moreover, in most new countries, especially

in the British colonies, are to be found young gentlemen, whose relatives prefer that they should be at a safe distance, and send them sums at regular intervals as long as they remain at the other side of the world. This kind of person, who is common enough to form a recognized class, and be dubbed a "remittance man," is, of course, a drain on his native land, and has exactly the opposite effect on the exchange, from that of the worker who is sending money home.

Another class of emigrant that causes a drain on the country of its origin is formed by the wealthy American heiresses who find English and European husbands and draw year by year large sums from the United States in the shape of dowries, so that this item in the trade balance—in the widest sense of the word—is commonly called the dowry drain. In this case Europe and England may be said to turn the American exchange in their favour by exporting conjugal affection.

Salaries of officials who go abroad to rule dependent countries are another item in the account. India has to remit goods every year in large quantities to England to meet the drain on it that is caused by the pensions of retired Indian Civil servants and military officers, and the claims on it

remitted home by those officers and officials who are saving part of their salaries while in active service. Here England exports protection and Government to India, and India sends her products to pay the bill.

Another very interesting charge that England, alone among the countries of the world, is able to make to its neighbours, so turning their exchanges in its favour, is the commission that it earns for lending its credit to them, so that they may ship goods to one another. Accepting bills is a profitable item in the financial services rendered by the banking communities in all the economically developed countries, but the others all confine themselves to accepting bills drawn against produce shipped to their own countries, the charge for which is in most cases paid by the local importer. One of the great evidences of England's supremacy as international banker is the fact that bills are drawn on her against goods shipped, for example, from Yokohama to Boston. This operation will be made more clear in my next chapter, in which I hope to deal with the bill of exchange in its various aspects. But it had to be mentioned here because it is a unique feature in the account with which England settles every year for the huge amount of

goods that she imports without making any tangible export.

It is not possible to attempt an exhaustive list of the services that are rendered by one nation to another, and so help to fill the gap in the published figures of the trade returns; but enough has been said to indicate most of the important items, and we are now in a position to draw up a rough balance sheet for England showing the chief features in her imports and exports of all kinds. It must be remembered that in nearly every case she is both importer and exporter, and it is the net balance that appears on one side or the other.

Imports.	Exports.
Goods and precious metals.	Marine transport.
Securities.	Coupons.
Pleasures of travel.	Insurance.
Riddance from undesirables.	Bankers' and Brokers' commissions.
	Labourers and servants.
	Conjugal affection.
	Government and protection.
	Acceptance credits.

The first item in the account is the only one about which it is possible to be approximately certain. The trade returns give the figures, and the table on p. 85 shows them for ten years.

It will be noted that the excess of visible imports has shown a tendency to decline. This

may be owing to the pace at which we have been importing securities in the last few years.

Year.	Excess of value of imports into the United Kingdom over the value of exports (including re-exports).		
	Merchandise.	Bullion and Specie.	Total.
	Million £.	Million £.	Million £.
1903	182	—	182
1904	180	−1	179
1905	157	6	163
1906	147	2	149
1907	128	5	133
1908	136	−7	129
1909	155	6	161
1910	144	7	151
1911	123	6	129
1912	146	4	150

There is no doubt in the case of the second item that our imports are far greater than our exports, though the amount of the excess is necessarily a matter of estimate. Whenever a foreign loan is issued in England, or subscriptions are invited to a company formed to buy and work a mine or a factory, or any kind of business, abroad, whenever our bankers lend money in a foreign centre, whenever our capitalists buy securities from foreign holders, whenever in fact we invest money abroad temporarily or as a lock-up, we are importing securities. Contrariwise, when foreigners buy securities in our markets, whether English or foreign, that have been held by Englishmen, we export securities, and likewise

when foreign loans or bonds that have been issued here are paid off, we send the securities back and take back our money. On balance we invest abroad much more than foreigners invest here, and we subscribe to new issues much faster than old ones are paid off. I have already quoted Sir George Paish's authority for a balance of about 160 millions a year as representing our net investments abroad. It should be noted, however, that against this import of securities we have to set the bankers' and brokers' commissions that we earn on the transaction, which have to be allowed as a set-off by the borrowers who send us the securities.

Another item on which we have more to pay than to take is foreign travel. American and Colonial visitors come here in shoals and spend money freely, but our exports to them—for they are exports in regard to their effect on the exchange market in spite of the fact that our visitors come to fetch them—are certainly smaller than our imports in the shape of Continental hotel bills and railway tickets bought by the flocks of British tourists who yearly explore Europe.

Riddance from undesirables is the advantage that we import when we ship the unfortunate

folk known as "remittance men" to a far land, and induce them to stay there by periodical payments which tend to turn the exchange against us. This drain seems to be all one way. At least I never heard of a foreigner sent to England by his friends and paid to stay there. Exiled potentates come here sometimes, and might possibly be included under this heading, but in any case the whole amount involved by this melancholy business is quite small.

Now we come to the other side of the balance sheet. On freight charges it is nearly all taking and very little paying. We must allow, though the Board of Trade forgot to do so in its calculations referred to on page 57, that the United Kingdom pays at least part of the profits of the German, American, Scandinavian and other ships that carry us and our goods to and from our shores. But there can be no doubt that on balance we take a huge toll on the world's over-sea trade in return for carrying it from port to port.

In the matter of coupons again, which I have taken to mean interest and dividend payments of all kinds, we have a big balance in our favour. We draw interest and profits from our investments in all parts of the world, and the rest of the world

draws, comparatively, a mere widow's mite from its investments with us. This is especially so, because most of its investments with us are in companies that we have formed to work industries abroad. When our rubber companies or South African mining companies declare dividends, and French or Dutch shareholders in them send the coupons to us to be encashed, they thereby have claims on London to sell and so turn the French or Dutch exchange against us. But we merely pass the claims on, probably taking toll of them by the way, to Malay or South Africa, which is producing the profits that our companies are distributing.

On the insurance account we draw yearly a big revenue on balance from the rest of the world. Lloyds and our fire and life and marine insurance companies do a large business in America and elsewhere abroad, and though they often have big losses to face, we may be sure that they make net profits on the whole or they would not be doing the business. But this stream is not all in one direction, for American offices collect plenty of premiums here.

As to remittances from labourers and domestic servants to their friends at home, it is probable

that the balance is in our favour. An American authority has estimated the amount yearly sent from the United States alone to Great Britain and Ireland as £5,000,000, and if we add the sums received in the same way from Canada and all our other colonies, the figures begin to look impressive as the imagination casts them up. Against them we have to set a similar drain on us through the homeward remittances of the foreign waiters and barbers who are to be found all over London, and the great foreign colony in the East End.

On the last three articles of export the balance is almost entirely in our favour. We draw on the United States for the "dowry drain" and repay it with the affection and social distinction conferred on American heiresses by their English husbands. Our officials and soldiers give protection and Government to India and Egypt and our Crown Colonies, and goods have to be sent thence to cover the remittances of their savings and later of their pensions. And our accepting houses export credit wherewith to finance the movement of goods from one foreign country to another, and thereby earn commissions, which come here ultimately in the form of produce.

If we work out a similar trade and services balance sheet for the other countries of the world, we shall find them all importing and exporting most of the articles in our list, with a balance on one side or the other. By far the greater part of the payments for all the goods and services that pass from one land to another in this huge boiling whirlpool of international trade is settled by the buying and selling in the exchange markets of the world of the claims of one country on the money of others. These claims take the form of bills of exchange.

CHAPTER V

COMMERCIAL BILLS

We have seen that Foreign Exchange is the business of buying and selling claims to foreign money, and we have examined the various kinds of international traffic in goods, services and securities by which these claims are created. Now we have to consider more closely the bills of exchange in which these claims are expressed.

The bill of exchange merits and rewards close consideration, for it is the most wonderful and magical instrument of credit that has ever helped to turn the wheels of trade and join all the nations together into a great commercial community with common interests and a common desire for peace and amity. It is one of those inventions that seem to be good for everybody and to make everybody better off, like the bad half-sovereign in the well-known story, which made everybody happy. You will remember that a workman gave the half-sovereign in question to a

poor woman who was weeping bitterly outside a church because she had not half-a-crown to pay for her baby's baptism. The workman was happy because he got *7s. 6d.* change for his bad half-sovereign, the woman was happy because her babe was christened, and the parson was happy because he got a half-sovereign which he did not know to be bad. The bill of exchange works with similar magical effect, without being bad. Sometimes it is bad, but the number of black sheep is infinitesimal, when compared with that of all the white-fleeced flock. When it is good, as it usually is, it is a perfect form of remittance by which payments from one country to another can be made with great cheapness and rapidity, to the benefit of producers and consumers in every civilized land; it is a perfect form of I.O.U., by which borrowers with good credit can raise the wind with extraordinary ease and economy; and it is a perfect form of investment, which is the pride and comfort of prudent bankers and others who want to keep their resources liquid and yet earn a fair rate of interest on them.

When you draw a cheque on your bank, you draw a bill of exchange. Your bank owes you

money because you have deposited money with it, or has given you the right to draw on it by making you an advance or allowing you an overdraft. You draw a cheque on it then and send the cheque to your landlord to pay your rent. Your landlord pays the cheque into his bank and he has got his money. His bank collects it from yours through the Clearing House. Your cheque has paid two debts. It has paid the debt that your bank owes you—or part of it—and it has paid your debt to your landlord.

Now a cheque is merely a bill of exchange payable on demand and drawn on a bank. It is the most convenient form of remittance ever known, but merely a form of remittance. The bill of exchange being commonly made payable some time after sight is a good deal more, but with that aspect of its manifold virtues we will deal later on. Let us first consider its efficiency, in the form of a bill payable at sight, as a means of remittance between one country and another, in other words, as the currency by which international trade is settled. In this respect it is exactly the same as the cheque with which we are all familiar. It is an order on a debtor to pay a certain sum. But the drawer of it, instead

of sending it to a creditor, which he might evidently do if he had a creditor in the foreign country on which the bill is drawn, more usually disposes of it by selling it to his bank, through whose hands it passes into the exchange market.

If a French wine maker sold £1000 worth of champagne to an English wine merchant, he would draw a bill on him for the amount; if at the same time he owed £1000 to an English market-gardener for rhubarb—I am told that a good deal of champagne is made out of English rhubarb—he could send his bill on the wine merchant to the market-gardener who would get the money from the wine merchant, and so the triangle would at once be complete, one bill having paid two debts without passing through the hands of any intermediaries.

In actual fact, however, the story of most bills is much less short and simple. The wine exporter draws his bill, not on the importing merchant, but on the merchant's bank or some accepting house—on which more anon—with which the merchant has made the necessary arrangements, and having drawn the bill he sells it, perhaps through his own bank at home, to a dealer in exchange. The dealer in exchange sells it to some

other Frenchman who has claims to meet in London and so wants a bill on London; the buyer sends it to London to his creditor, who presents it and collects the proceeds through his bank, and so the one bill, having gone through all these hands, has paid two debts and everybody is satisfied.

Now we begin to see how relevant to the question of the exchanges was all the discussion about imports and exports in which we indulged in my last two chapters. Every import that we make from France or any other country means that somebody there has a claim on our money, and can draw a bill on us. Every export that we make means that some one abroad has a claim to meet here and wants to buy a bill on us. And so it follows that every import that we make, whether of goods or bullion or services or securities, tends to turn the foreign exchanges against us, because it means that some one abroad has a bill on London to sell and the offer of his bill will tend to depress the price in francs, or milreis or whatever the currency may be, of the English pound. And, contrariwise, every export that we make tends to turn the foreign exchanges in our favour, because it means that some one abroad will want to buy a bill on London, wherewith to settle his debt, or else

that some one here will have a bill on a foreign country to sell in our exchange market, which will produce exactly the same effect.

As a rule, however, the debts between England and other countries are settled in bills drawn on London. As we have seen, every bill pays two debts. It pays the debt of the merchant on whom or on whose banker it is drawn, and it pays the debt of the merchant abroad who buys it and sends it for collection to his creditor in the country on which it is drawn. It is more convenient to foreigners to draw on us, because they are thus able to get immediate cash for their claims by selling them to the local exchange dealers, and it is more convenient to London to be drawn on when a debtor and to be paid in bills on London when a creditor, because it is thus saved from some of the complications of calculating foreign currencies. London's acceptance machinery and discount market are also more elastic and more fully developed than those of any other centre, and, as has already been said, bills drawn on it are more popular and easily negotiable than claims on other places.

So far we are considering the bill merely as a form of remittance, that is to say, as a cheque or sight draft. In this case it is quite a simple

matter. It is merely an order to pay on demand a certain sum of money to Mr. Jones or Mr. Robinson or his order. The man who draws the bill and signs it is the drawer, Mr. Jones is the payee, and the bank or firm on which the bill is drawn is called the drawee. If it is drawn on a clearing bank it can be paid in by its holder straight into his own bank and collected through the clearing house. If it is drawn on a firm or company not in the circle of the clearing, it has first to be presented to the drawee and accepted. That is, the drawee writes its signature across the front of the bill and stamps it "accepted payable at such and such a bank," naming a clearing bank. The bill can then be paid in and cleared like an ordinary inland cheque. The meaning of the phrase "pay to Mr. Robinson or to his order" is just the same as in the case of an ordinary cheque. Robinson can endorse the bill and hand it on to Smith, who thereby becomes entitled to the sum named on it.

But the bill of exchange becomes a much more interesting and versatile instrument when it is drawn payable at a future date. It is of course less valuable in this shape to the original drawer, and we saw in examining the table of exchange rates that bills drawn at eight days' or three

months' sight naturally fetched a lower price than sight drafts, because they did not become cash until after a certain lapse of time, and so could only be turned into cash at once by being sold under discount, that is at something less than their face value at maturity. The extent of that something less obviously depends on the rate of discount current in the centre on which the bill is drawn. If the discount rate on three months' bills is 4 per cent. per annum, the present value of a three months' bill for £1000 will evidently be £990 or thereabouts, since three months is roughly a quarter of a year, and 1 per cent. is a quarter of 4 per cent., so that we have to knock 1 per cent. off the value on maturity of £1000, bringing it down to £990.

All this, of course, is calculated and allowed for by the exporting merchant, who knows that he will be expected to take payment by drawing on the importer who buys goods from him a bill payable three months after sight. He allows for it in the price that he takes for the goods, and the importing merchant who thus practically asks for three months' credit, pays for it, as is fair, by giving a higher price for his goods than he would have submitted to if he had been prepared

to be drawn on at sight. By gaining this three months' interval he expects to be able in the meantime to dispose of the goods at a profit and so to have cash in hand to meet the bill when it falls due. Thus we see that the bill of exchange makes good its claim to be not only a perfect means of remittance but a most efficient instrument of credit, by the discovery of which industry has bridged over the gap between the arrival of goods and their sale.

The extent of the bill's effectiveness in providing the exporter with immediate cash will evidently depend largely on the standing and credit of the drawee—the firm or company whom it orders to pay so much. If a French hat-maker sends a shipload of Parisian creations to a London milliner, and draws on the milliner at three months' sight, the number of francs that he will get for his draft in Paris will vary in accordance with the price that the buyer of the bill expects to be able to sell it for in London, in other words at the rate at which his London correspondent may be expected to discount a three months' bill drawn on the said milliner. The milliner being an obscure trading firm, the bill will be merely a third-rate trade bill, and so the rate at which it will be discounted will be far above the

rate quoted for fine bank bills,* in other words the cash price of the bill will be very much lower than if it had been drawn on a first-class name, whose acceptance would at once have stamped the bill as gilt-edged, and one that the most meticulous holder could put into his portfolio and sleep on soundly.

Hence has arisen the curious and interesting practice by which the business of accepting bills has been specialized in by a few merchant firms of first-rate standing, and by the banks both private and joint stock. It is easy to suppose that the practice may have arisen through those merchants whose credit stood highest in the public estimation, lending their names to the bills of their less eminent brethren, taking a commission from them for so doing and securing themselves as best they could so as to make sure that before the bills became due the merchant or tradesman on whose behalf they had accepted should not fail to supply them with the cash wherewith to meet the bills.

In so far as they were able to secure themselves efficiently, they never had to provide any cash themselves to meet these vicarious acceptances.

* Bills drawn on the great accepting houses and banks are known as bank bills, as distinguished from trade bills, drawn on ordinary merchants and traders.

The commission that they earned was ample—much more ample in the good old days when the practice first grew up than in these times of competition and commission cutting—and so many firms gradually devoted themselves to this branch of their business, gave up, to a large extent, their function as merchants, and confined themselves to letting out their names so that those who were still in the stress of mercantile traffic, might thereby finance themselves more cheaply.

It was also natural enough that the banks, when applied to by their customers whose credit was not first-rate, should be prepared to hire out their acceptance credit on the same lines. Bankers are, of course, exceptionally well able to know how much a man is worth and what kind of business he is doing, and consequently, how far it is safe to accept bills on his behalf, with the expectation that he will be ready to produce the funds necessary for meeting the bills when they fall due. And so this curious business has arisen by which the accepting houses and banks make themselves, by their acceptances, liable for hundreds of millions of pounds' worth of bills in the course of the year, without ever having to provide any cash, except in the quite exceptional cases when something goes

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wrong with the customer on whose behalf the acceptance has been given. When this happens the bank or accepting house has itself to pay the bill on maturity, and collect the money, if and when it can, from its customer.

But since one of the functions of the bill is the provision of cash to the drawer, it is evident that somebody must be prepared to turn it into ready money. That somebody is the buyer of the bill, that is, in the first instance, the bank or dealer in exchange that buys it in the country in which it is drawn, and finally the discount market in London, or any other centre, on which it is drawn. After being accepted by a first-class house or bank, the bill of exchange can be disposed of in Lombard Street at a price which will depend on the market rate of discount then ruling, and will, most probably, be sold ultimately through a bill broker to one of the big banks to be held by it as the most perfectly liquid form of investment that can be found, because it only has to be held until maturity and then presented to the acceptor to be turned into cash. In this respect the bill of exchange differs, very much to its advantage, from the kind of securities that are quoted on the Stock Exchange. If a holder of the latter wants to turn

them into cash he has to find a buyer or someone who will lend on them. In the case of many such securities—but by no means all—he can rely on always finding a buyer at a price; but the price may be such as will be extremely unsatisfactory to the seller. With the bill of exchange it is a case of face value at due date, and the bankers who hold bills can easily arrange to have a certain number maturing every day, so that when they want to reinforce their cash resources they have only to sit still and let their bills run off. If this did not suffice and the bank were still gravelled for lack of ready money, it could pledge or dispose of its bills before maturity, but this is very seldom done, since it might lead to uncomfortable inferences concerning the strength of the bank's position. Other holders of bills, however, and many others besides banks constantly keep a supply of bills as a liquid investment, can and do turn them out and sell them when it suits their convenience.

Having thus seen the chief beauties and utilities of the bill of exchange—though so far on one side only of its manifold capacities, that of financing trade—let us trace the history of a bill and make its functions more comprehensible by a concrete example. We will suppose that Mr. John Bull,

of Liverpool, imports cotton from Christopher Columbus, of New Orleans, and to that end has arranged for an acceptance credit with Messrs. Rudesheimer & Sons, of London, an accepting firm of first-rate standing. The transaction will be opened by Messrs. Rudesheimer sending to Columbus a letter more or less on the following lines, though the actual form of these Letters of Credit has many varieties :—

590, St. Helen's Place,
London, E.C.,
August 2, 1912.

Mr. Christopher Columbus,
1001, 54th Street East,
New Orleans, U.S.A.

Dear Sir,

We hereby beg to confirm to you Credit No. 50 opened with us in favour of you by Mr. John Bull, of Royal Exchange Buildings, Liverpool, for £10,000, say ten thousand pounds, for which amount we shall duly honour your own drafts at sixty days' sight drawn in New Orleans.

This Credit expires unless previously cancelled on August 2, 1913. All drafts against it must be drawn and duly advised to us before that date accompanied by :—

Consular invoice;
Bills of lading;
Insurance certificate.

Please insert in your drafts the number and date of the Credit and the initials of the firm by whom you are accredited. A copy of advice to be attached to each draft drawn under this Credit.

We are, Dear Sir,

Yours truly,

RUDESHEIMER & SONS.

£10,000.

When this document has come into his hands, Columbus can buy cotton from the growers and ship it to John Bull in Liverpool, drawing bills to any amount up to a total of £10,000 payable at sixty days (this is the commonest usance for bills drawn in America) after sight. The amount that he can draw against each shipment is usually 85 to 90 per cent. of the invoice value of the goods, the margin being required as a protection for the accepting house. The necessary documents, as we saw from the letter of credit, were a consular invoice, that is to say a copy of the invoice certified by our Consul in New Orleans; the bill of lading, which is a receipt from the ship's captain stating that so

many bales have been shipped; and evidence that the goods have been duly insured against all risks of fire and shipwreck. With these documents attached the bill drawn by Columbus can, if he be a respectable and trustworthy person, be at once sold by him to a bank in New Orleans, which will endorse the bill. More probably he would sell the bill before he drew it, and so would draw it payable not to himself, but to the order of the Tenth National Bank of New Orleans. In either case, if there is anything wrong with the bill and it is not accepted on presentation in London, the bank will have "recourse" against him, that is, make him liable for the amount. The price that the bank would give him would depend on the current price in the New York exchange market of sixty days' drafts on London, and would be diminished by the bank's toll on the transaction for its risk and trouble. The bill would run in some form as follows:—

£690. New Orleans,
September 1, 1912.

At sixty days after sight of this First of Exchange (Second unpaid) pay to the order of the Tenth National Bank of Orleans,

Six hundred and ninety pounds sterling

Value received, and charge the same to account as advised.

CHRISTOPHER COLUMBUS.

To Messrs. Rudesheimer & Sons,
London.

No. 50. J.B. August 2nd, 1912.

When the bill is first drawn it has nothing to recommend it except the signature of Columbus, the knowledge possessed by his bankers that he has been authorized to draw on Rudesheimer by the letter that he has been able to show them, and their belief that he has made a genuine shipment of goods, and further that he is worth powder and shot if, owing to any irregularity, they have to take recourse against him. But when the Tenth National Bank of New Orleans has bought it and endorsed it, the bill is very much improved in appearance, since the Tenth National Bank has thereby made itself liable for the bill. Consequently when the bill arrives in New York the New Orleans Bank can easily sell it to a New York bank, and so it comes into the exchange market and helps to turn the New York exchange against London. It is an offer in New York of a claim to money in London and so tends to depress the

price in dollars of money in London. The New York bank, which we may suppose to have been depleting its balance in London by selling drafts on it at a time when drafts were scarce and dear, sends this bill with others to its London agents, who immediately take it with the documents still attached to the office of Rudesheimer & Sons for their acceptance. They sign their name across the front of it and stamp it—

Accepted Sept. 15, 1912.

Payable at the Town and County Bank, Ltd.

and now with their acceptance on it it is a gilt-edged bill, payable sixty-three days (throwing in the days of grace) after September 15. Rudesheimer & Sons retain the documents and return the bill to the agents of the New York bank; Rudesheimers then probably (though there are infinite varieties of practice with respect to this very important question of the documents) forward the bill of lading, etc., to John Bull in Liverpool, thus enabling him to get possession of the goods on their arrival. The bill has come across by mail in an ocean greyhound while the cotton is slowly ploughing through the water in a twelve-knot tramp. Rudesheimers, however, have not altogether parted with their hold on the cotton. They expect John Bull to give

them a warehouse receipt for it, which means to say that he cannot dispose of it without their authority, which they would only give in exchange for a payment by him of the amount to which they are liable under the bill. But it is usual in the cotton trade for the accepting firm to release the goods ten days before a bill falls due, during which time they are not covered by any collateral security, and have to rely entirely on the good faith of their customer. Having sold the cotton, John Bull sends a cheque to Rudesheimers for the amount of the bill plus their commission, and the business is ended as far as he is concerned.

In the meantime the bill has been sold by the New York bank's London agent to a bill-broking firm or discount company, which has disposed of it in turn to the Amalgamated Bank, Ltd., in whose portfolio it remains until the date of maturity when it goes through the Clearing House and is an item in the large total daily cleared between the Amalgamated and the Town and County. Its effect will be to transfer £690 to the Amalgamated's balance at the Bank of England from that of the Town and County, and the latter will debit the account of Messrs. Rudesheimer & Sons, who, as we have seen, have already been put in funds by John Bull.

The case that has been traced above was one under which a bill was drawn on an English accepting house against a shipment of goods to England. Let us now consider the history of one of the many thousands of bills that are annually drawn on English accepting houses against goods that are shipped from one foreign country to another. I have already called attention to the very remarkable fact that England is able thus to take toll of trade between foreign countries, trade in which she has no concern whatever, by lending her acceptance to drafts drawn against it. In order to make sure that I am not exaggerating the extent of this business, let me quote you a passage from an American authority, Mr. Franklin Escher. This writer is describing the processes involved by a shipment of silk from China to Paterson in New Jersey, and shows that a bill against the shipment is drawn on London.

"A pertinent inquiry," he continues, "at this point is as to why the letter of credit for silk shipped from a city in China directs that drafts be drawn on London—as to why London figures in the transaction at all? The answer is that drafts on London are always readily negotiable, and that London is the only city in the whole world, drafts on which

are readily negotiable in all places and at all times. A draft on New York or on Berlin *might* be negotiated at a point like Canton, but to be sure that the exporter of the silk will get the best rate of exchange for his drafts, the drafts must be drawn on London, the financial centre of the world."*

It would have been interesting if Mr. Escher had gone a little further and told us why a draft on London has this supreme merit of ready negotiability in all places and at all times. As he has not, we must do so for ourselves, by saying that it is, in the first place, because England's trade is so big and so world-wide that drafts on her are always wanted in every place where men trade actively; in the second, because the English accepting firms and banks are known all over the world to be exceedingly safe. Mr. Paul Warburg, an eminent authority on this subject, lately urged, in a paper addressed to the American Monetary Commission, that in order to save the United States from the tribute that she has to pay for having her international trade financed by foreign accepting houses, the American National Banks ought to be allowed to give acceptances, which the law at present forbids. With all deference to this high authority,

* "Elements of Foreign Exchange," p. 145.

I doubt whether his remedy would mend the evil, as it seems to him, of which he complains. If drafts on America were wanted, there are plenty of private firms which could accept; but in New York both the private firms and the banks are believed by the outside world, rightly or wrongly, to be often much more deeply involved in stock-market operations than would be thought safe and proper by the English accepting houses and banks.

English accepting houses make a special study of their credit and maintain it by being quite aloof from speculative entanglements, and so bills drawn on them have a standing that none other can touch. But lest we should feel too much puffed up with patriotic pride from the contemplation of this very gratifying fact, let me mention another very interesting one, namely that almost all the chief English accepting houses have foreign names and have been established by strangers within our gates. Hence it was that in tracing the story of an imaginary bill above, I drew the bill on a firm named Rudesheimer & Sons. A third reason for the world-wide popularity of the bill on London is the one mentioned in my first chapter, namely, the certainty that it can be turned into gold; and yet another is the unrivalled elasticity and freedom of

our money market, with its organization of banks, discount houses and bill brokers, which enables the bill on London to be easily and cheaply discounted.

Without inquiring further into the why and wherefore, let us return to the fact, which is established beyond peradventure by foreign authority, and its illustration. We will suppose that a Cincinnati leather-maker, whom we will call Mr. Jonathan S. Tanner, wants to import hides from the Levant. In order to enable his seller to draw a bill that will be most favourably negotiable and easy to dispose of, he arranges with the Fifth National Bank of Cincinnati to open a credit with Rudesheimer & Sons, of London, in favour of Mr. Cipriani, of Damascus, against shipments of hides to Cincinnati. Cipriani ships the hides and draws the bill on Rudesheimers, and sells it, with invoice, bill of lading and insurance receipt attached, to the Levantine bank, which sends them all to its London agent, who presents them to Rudesheimers for acceptance. Rudesheimers, having satisfied themselves that all is in order, accept the bill and hand it back to the Levantine bank's agent, who probably sells it in the discount market. The bill of lading and other documents are sent to the Fifth National Bank of Cincinnati by Rudesheimers, who thus in fact part with the

collateral that secured them against the risk that they took in accepting. This is a matter of small moment to them, however, since they rely not on Jonathan S. Tanner, but on the Cincinnati bank, whose standing they regard as undoubted. Control over the hides has passed into the hands of the bank, which now holds the documents.

On the arrival of the hides Tanner will want to take them and make them into leather, and the bank will have to make over the bill of lading to him before he can touch them. The bank still tries to keep some control over the goods in the form of a warehouse receipt, or a trust receipt, but if anything goes wrong with the affairs of Jonathan S. Tanner, the bank will have had a hard task to show which of the pieces of half-manufactured leather in his evil-smelling vats represents the hides against which it has arranged that Rudesheimers should accept Cipriani's bill. Rudesheimers have to meet the bill on maturity or be dead as an accepting house; and the bank has to provide them with funds to do so, and make good as much as it can out of the wreck of Jonathan S. Tanner's fortunes.

If all goes well, however, Tanner turns the hides into leather and sells it, pays the money to the Fifth National Bank of Cincinnati to meet the

bill on maturity in London, and the transaction is closed, to the satisfaction of all concerned, by the Cincinnati bank's buying in New York a sight draft on London for the amount of the bill plus Rudesheimers' commission, and sending it soon enough to reach Rudesheimers at least one clear day before the due date of the bill.

It is interesting to note the different effect on the exchanges of the two bills whose story we have traced.

In the first case, of John Bull and his cotton, England imported goods and to that extent turned the American exchange against herself, since, as we have seen, every import of goods, services or securities tends to turn the exchange against the importing country by creating a claim on its money which is sold in the country where the bill is drawn, and so tends to depress the price of English money as expressed in the local currency. Columbus drew a bill on London against his cotton, and the bill was sold in New York, so tending to depress the price in dollars of bills on London.

In the second case, the bill on London drawn by Cipriani and sold to the Levantine bank tends to turn the Damascus exchange against London, but against this we have to set the effect, later on,

of the purchase of a draft on London by the Cincinnati bank, which will tend to turn the New York exchange in London's favour, because it will be an addition to the demand in New York for claims on money in London. In this case America really owed the money to Damascus, but borrowed it for a time in London. London paid Damascus and when the time was up, London was paid by New York, with something extra for the use of its credit. What London did was to import a promise to pay, or security, from America, and to export it when it was met on maturity by a draft on London bought in New York. The import turned an exchange—Damascus—against it; the export turned an exchange—New York—in its favour.

In tracing the history of both of the commercial bills that we have followed from their birth to their extinction, a certain amount of blank credit has been seen to enter into the transaction. That is to say, at a certain stage in the proceedings the accepting house, or the bank which arranged the credit, parts with the bill of lading to the importer, and so gives him control of the goods, though it still tries to keep a lien on them by means of warehouse receipts or trust receipts. In cases in which accepting houses are drawn on by exporters

it is almost inevitable that this element of blank credit should enter into the proceedings sooner or later, except when the accepting house still acts as merchant and is employed by the importer to sell the goods for him. When the arrangement is on this wise, the accepting house is on a bed of roses; it does not part with the goods until it sells them itself, and its only possible risk lies in the chance that the bill of lading may be forged and the goods may not come at all or be found to be worthless; even then the loss would fall, not on the accepting firm, but on its customer, if he were able to stand it.

There is, however, a class of bill, in the case of which the documents—bill of lading, etc.—are not given up on acceptance, but are retained by the holder of the bill. This kind of bill is called a documentary bill, because the documents remain in attendance on the bill and are only given up on payment; on the other hand, the acceptor has the right at any time during the life of the bill to pay it under rebate, and so get possession of the documents and of the goods. If the bill has three months to run and the acceptor finds a buyer for his goods a month after acceptance, he takes the bill up by paying its face value less the rebate, which is the allowance, calculated according to

an agreed rate of interest, which is usually ½ per cent. above the bankers' published rate of interest on deposits, for the present value of a bill with two months to run. As the acceptor has this right, it follows that bills of this kind cannot be discounted in the usual manner, though it is sometimes possible for the holder to raise money on them by pawning them on the understanding that they are to be surrendered if and when the acceptor wishes to take them up.

Bills, then, of the kinds enumerated above, make up the enormous mass of the bills drawn on England against commercial transactions. Since every import means that a bill can be drawn upon us the gross figures of last year's trade show that the volume of bills to be drawn on us on our imports of goods and bullion came to 814 million pounds' worth, without taking into account those drawn on London against goods sent from one country to another. If we add the total of our imports of securities, we arrive, according to Sir George Paish's estimates, at another £160,000,000; and if we add the other items of our expenditure abroad we see that bills to a total of more than 1000 millions may have been drawn on us in the course of the year. Against this

imposing total of claims against us by our over-sea providers of goods, metals, services and promises to pay, we have to set the total of our claims against our foreign friends and colonial kinsmen for goods, metals, and coupons that we export and services that we sell in the shape of freights, brokerages and the other items in the account rendered in a former chapter. Since the claims against us and our claims against our customers must roughly balance, for reasons already set forth, it follows that every bill drawn on us by a seller to us is wanted as a means of remittance by a buyer from us, and so this huge mass of mutual indebtedness is settled by the interchange of these magical bits of paper which pass from hand to hand in the exchange markets of the world, forming the currency of international trade.

CHAPTER VI

FINANCE BILLS

Even more magical, perhaps, than the bills drawn against shipment of goods are the bits of paper that are made into currency with no sale of goods or services or securities as a basis, but merely by way of raising the wind, and because two big houses on opposite sides of an ocean have confidence one in another, and buyers of bills have confidence in them.

History tells us a curious tale of a whole batch of finance bills drawn on hapless prelates without their knowledge or consent, and yet duly accepted and paid. This financial masterpiece was achieved in or about the year 1255, when Pope Alexander IV. wished to get control of the Kingdom of Sicily, which was held by Manfred, natural son of the Emperor Frederick II. Manfred showed no inclination to meet the wishes of the Pope, and the Pope finding a good deal of difficulty in raising

the money for the purpose of compelling him, proceeded to make the question of Sicily into a crusade, maintaining that Manfred was a more terrible enemy to the Christian faith than any Saracen, and at the same time proposing to give the crown of Sicily to Henry III. of England for his second son Edmund. As the English king had consented to be given the crown, the Pope naturally thought that England ought to find the money, and accordingly levied a tenth on all ecclesiastical benefices in England for three years, and gave orders to excommunicate all bishops who did not make punctual payment. This exaction did not produce enough cash, and so an ingenious English bishop who was then at the Court of Rome advised the Pope to draw bills on all the English bishops and abbots. These bills were granted to Italian merchants.

The Pope's legate in England summoned an assembly of the drawees to explain the position to them, for the unfortunate clergymen, who had thus had bills drawn upon them without their consent and without acknowledgment on their part of any debt, were naturally unwilling to accept the bills, or pay them. The Bishop of London said that if the Pope and the King knocked off his mitre

he would clap on a helmet. Nevertheless, the threat of excommunication finally prevailed, and the bills had to be met. The modern finance bill has no threat of excommunication behind it, but it has equally miraculous powers of producing credit and currency out of an article of faith. In its case the faith is in the names on the bill.

A great financial house in America, for example, sees an opportunity for making profitable use of money either through the stock-markets or the produce markets or any other outlet that American ingenuity can devise. It makes arrangements—or very likely has a standing arrangement—with an equally eminent English house to draw on it at three months' sight, and the result is a beautiful gilt-edged bill, on which the name of the drawer and drawee vie with one another in excellence. This bill can be sold in New York, so providing the American operator with funds, sent to England for acceptance and then discounted in the usual manner and probably bought by one of the big English banks and held as an investment until maturity. Neither of the parties to the bill has to find a penny until the due date. The money is found by the bank which buys the bill. The drawer has three months in which to conduct his

campaign, and if at the end of them the spoils of victory are in his hand, he therewith buys a sight draft on London and sends it to his ally to meet the bill. If he still wants more time, he can draw another bill at three months' sight and buy the necessary sight draft with the proceeds. In any case the money to meet the expiring bill has to be in the acceptor's hands one clear day before its maturity.

There is thus a beautiful simplicity about finance bills. There is no trouble with bills of lading and warehouse receipts and the insurance of goods on their journey. If any collateral is pledged, it consists of stock-exchange securities, usually placed in the hands of a third party, the drawer being bound, if the securities fall in price, to deposit more so as to maintain the value of the collateral on a level with that of the bill at its maturity, or more usually 10 per cent. or so above it, so that there may be a margin in favour of the acceptor. Often, however, the standing of the houses that carry out these operations is so high and their relations are so close and intimate, that no security is pledged and it is a case of blank credit from first to last. If collateral is pledged, it is evidently a safer security for the acceptor

than that of the bills of lading and other documents that accompany the commercial bill. For we saw that in the case of commercial bills, there is nearly always a period during which the acceptor on behalf of a customer has parted with the documents and the credit is more or less blank. And there is always the danger of a forged bill of lading.

Finance bills are also, occasionally, drawn by Foreign Governments as a means for raising funds temporarily, usually with a view to a larger loan operation later, out of the proceeds of which the bills drawn are met at maturity. For these operations a small syndicate of banks and accepting houses is usually formed so that the amount to be drawn on one name may not be too heavy. These kites, as finance bills are sometimes called, are in the ordinary form of bills of exchange ordering the accepting firm to pay so much at such and such a date after sight. The Treasury bills which are used by our own and other Governments as a temporary means for borrowing are not bills, or orders to pay, but promises to pay by the borrowing Government, and so are more like bonds than bills. But they usually resemble bills in one respect, namely, that they carry no coupons and are sold and dealt in under discount.

At first sight it would seem that finance bills can be created to any extent to which the drawers and acceptors like to agree. This is very nearly true, but not quite, for the drawer and acceptor depend on being able to sell the bill. A bill drawn on London is of no use if the London discount market will not buy it, and though it is exceedingly rare for bills drawn on a well-known London name to be looked on askance, it does sometimes happen, and the accepting houses know that their lives depend on not putting their names to more paper than the discount market thinks enough for them.

If Rudesheimer & Sons, whom we created for purposes of illustration, were ever to find that they had accepted so many bills that bill brokers were remarking, in their pleasant colloquial manner, that there was a fearful lot of Rudesheimers' paper about, and that the managers of the big banks, who are continual buyers of bills, had intimated that they had got enough Rudesheimers and did not want any more, they would know that their credit had had a shock from which it would take years to recover. But within this limit there is no let or hindrance to the creation of finance paper. The private houses that engage in its production do not publish any figures. The joint stock banks issue

monthly statements, but there is, of course, nothing to show how much of the acceptances therein displayed are finance bills, and how many have genuine trade transactions behind them. Moreover, the total of the joint stock banks' acceptances, big as it is in the aggregate, is so small in comparison with the large figures of their liabilities on current and deposit account, that it usually almost escapes notice.

The effect on the exchange of the creation and sale of a finance bill is, as need hardly be said, just the same as in the case of a commercial bill. The sale of the bill tends to depress the exchange on London, and the purchase of the bill by which the acceptor is put in funds to meet his liability tends to put the exchange up again. The acceptor, by allowing the drawer to draw on him, imports a security, which is in the form of the undertaking entered into by the drawer to remit before the bill falls due. When the final remittance is made, the acceptor exports a security, by acknowledging the receipt of the money which cancels the drawer's liability.

There are several variations of the finance bill, or rather there are several variations of the causes that encourage people with good credit to create

them. So far we have considered a case in which an operator wants to raise money and does so by drawing on a correspondent abroad and selling the draft so created. Since the cash price that he will get for his draft in his local market will depend largely on the rate of discount current in the centre on which the bill is drawn, the effect of the operation practically comes to this, that he borrows abroad at the rate of discount in London instead of paying the rates which he would have been charged by New York money-lenders. If he draws at three months' sight and the three months' rate in London is 4 per cent., it is obvious that the cash price of his bill in New York will be less than if the three months' rate in London is 2 per cent. In the former case every £100 in his bill will be worth roughly £99 when it gets to London, in the latter it will be worth £99 10*s*. So here we begin to see the practical working of one of the most important items in the problem that has to be unravelled by those who try to forecast movements in the exchanges, namely the relation between discount rates and rates of exchange. Foreign operators who want to raise money at home by the creation and sale of bills on London will do so at a greater advantage, and consequently more readily and in

greater volume, when the discount market in London is working at low rates. In fact the first question which an American who proposed to raise money by the sale of a finance bill would have to consider—and get an answer to by telegraphing to London—would be the price at which a three months' bill on London could be sold there "to arrive," that is, a week or so ahead when it will have had time to cross the ocean. Hence, since we know that every sale of a bill on London turns the exchange against us, it follows that low rates of discount here tend to turn the exchanges against us, since they make it cheaper for foreigners to borrow here by selling finance bills drawn on London.

Then there is the finance bill that is created purely as an exchange operation, in order to feed a demand for money elsewhere when the supply of bills is not big enough to meet the needs of those who have remittances to make. For instance if Paris is indulging in one of its enthusiastic bull campaigns in Kaffirs and buying South African shares with that whole-hearted devotion that sometimes seizes the French public, there will be a great and sudden increase in the demand in Paris for money in London—that is for bills on London —to pay for these French purchases of securities.

And if, at the same time, owing to the failure of the French wine crop or wheat harvest, the course of actual trade has been adverse to the creation of French claims on London, the price of English sovereigns in Paris will tend to soar up towards 25 francs 30 centimes. This demand will be met to a certain extent by French houses that have balances to their credit in London, and so are in a position to draw on London and supply some of the bills that are wanted; but it will also, in all probability, be met largely by the drawing of finance bills and the creation of drafts drawn on London firms which do not owe anything to Paris, but allow themselves to be drawn on for a consideration. As these bills are, from the nature of the case, drawn payable some time after sight, it follows that the price that they will fetch in francs will be much more satisfactory if the discount rate in London is low. So here again we find the rate of exchange and the rate of discount in the market on which the bill is drawn acting and reacting on one another.

Another class of bill that has nothing but finance behind it, though it is brought into being by a more or less genuine debt, is the kind of bill that is drawn on a loan-issuing house by a borrowing

country. If Chile raises a loan in London, London becomes for the moment her debtor by becoming her creditor. London lends the money and has to pay it. Some day Chile will have to repay it, but that is a question that does not concern her for the moment. Having exported a new batch of bonds Chile can draw bills on the London banking firm which has raised the money for her, and so she turns the exchange against London, and can supply bills to Chilian importers who have to pay for goods bought in England or in other countries. Later on it is the other way round. Every half-year when the interest on the loan falls due, England will have coupons to export and Chile will have to buy bills on London to meet them, and as the loan is redeemed by annual drawings or purchases in the London market, England will have redeemed bonds to export and Chile will have to buy bills on London to meet them likewise.

Domiciled bills are a variation on bills drawn on England to finance shipments of goods to a foreign country. They are drawn on a foreign country, but are accepted payable in England. For instance, if cotton is shipped from America to Italy, it is often arranged that the exporter draws a bill on an Italian bank, which accepts it,

payable by a London bank or firm. They are then sent to London to be discounted, but since the London bank or firm at which they are payable has not made itself responsible by accepting, and only pays the bill at due date if it has received the money in the meantime from the Italian bank, the rate at which such bills are discounted is usually about a quarter to a half per cent. per annum above the current rate for fine bills with an English acceptance.

These bills are really foreign since a foreign bank is ordered to pay, but their acceptance "payable in London" gives them a domicile in London, and so they are known as foreign domiciled bills, or, briefly, "domiciles." They are almost always drawn in pounds sterling, but, if drawn in the currency of the accepting bank's country, they are usually accepted payable at a stated rate of exchange in London. By the time they come to London they are usually pure finance bills, for the goods and the documents have, in most cases, gone to the country on which the bills were drawn; and they are only discounted in London because it is expected by those who buy them that the bank or firm named by the foreign acceptor will have been put in funds to meet them before they fall due.

CHAPTER VII

DISCOUNT AND EXCHANGE

LOOKING back over the ground that we have covered, we see that we have arrived, in the course of our journey, at three outstanding facts.

First, that the subject matter of Foreign Exchange is the buying and selling in any financial centre of the monies of other countries, that is to say, the exchanging of foreign monies for the money of that centre; and that the prices at which these monies are exchanged, depend like the prices of everything else on supply and demand.

Second, that variations in the supply of and demand for foreign monies depend on the commercial and financial relations of one country with another. The exports made by a country of goods or services or securities give it claims on other nations' monies, and the imports that it makes of goods and services and securities give other nations claims on its money.

Third, that these claims are expressed in bills of exchange, which are bought and sold in the exchange markets, and the supply of and demand for which is the immediate cause of movements in rates of exchange.

We have also seen that every bill of exchange can pay two debts. A bill drawn on an English importer pays the debt that he owes for goods, and being sold to any one who owes money to an English exporter can be remitted to him in payment. Further, that most of the claims between England and her foreign commercial and financial connexions are settled by means of bills drawn on English firms and banks, in other words, that the most active markets in Foreign Exchanges are in foreign countries.

With these conclusions in our knapsacks, culled in our journey through the tangled jungle of this thorny subject, we can now go forward to a clearer understanding of the main influences that turn the exchanges now one way and now the other. It is already evident that these main influences must be looked for in the commercial and financial relations of any country with the rest of the world. If it is importing more, on balance, of goods and services and coupons and

securities than it is exporting, it will have more claims to meet than it has claims to sell, the exchanges will move against it, and its currency will be depreciated.

We have seen that bills of exchange may be roughly divided into two great classes, commercial bills and finance bills, and that the simplicity of this classification is upset by the fact that there are some bills which hover on the border line, and, though apparently finance bills, are drawn in anticipation of a creation of commercial bills and so are to a certain extent amphibious.

This rough division into commercial and finance bills corresponds to a similar division in the monetary relations between one country and another. These relations depend largely on, first, the exchange of goods and commercial services; and second, the exchange of securities and financial services. Of these two divisions the first is on the whole steadier and less liable to fluctuation than the second, and it is also much less susceptible to control and regulation by those whose business it is to watch over the fluctuations in exchange and influence them when they need control.

Apart from war or pestilence or earthquakes,

the trade relations of one country with another proceed year in and year out on a jog-trot and fairly even course, with fluctuations that may be compared to the ebb and flow of the ocean tide. Bad harvests or strikes will modify them, and sometimes a Government will build a sea-wall in the shape of a protective tariff that will alter the whole shape and size of the coast. But Governments that take these measures are generally also those which do their best to encourage their citizens to export, and for everything that they export they must take something from somebody in return, unless they are going to give the goods away. And so a sea-wall in one place is usually set off by a big inrush of water in another. The course of the tide is altered, but its level is not much changed.

Activity or quiescence in the factory which turns out foreign investments is also an influence which affects the trade ebb and flow. When we are importing securities rapidly, and investing more than usual in foreign countries, it nearly always happens that we export more goods. Obviously we must export more of something—services or metals or goods—but, in fact, free investment abroad is generally accompanied by

big exports of goods. Which causes which, is "a question to be asked," as Falstaff says, but it need not necessarily be answered on this occasion. It is usually assumed that our imports of securities cause our increased exports of goods. But a contumacious controversialist might easily contend that the wind is on the other cheek, and that it is the craving of young countries for commodities that they cannot yet produce, that causes them to mortgage their expectations and export bonds and stocks and shares.

All these fluctuations, however, are of comparatively small extent when viewed by the side of the huge totals of the world's traffic in goods, and still smaller when compared with the fluctuations in the amount of its traffic in securities and financial services. As we have seen already, the volume of this latter traffic is easily influenced by movements in rates of interest and rates of exchange. A rise of $\frac{1}{8}$ in the three months' discount rate in London may prevent the drawing of a score, or a hundred, of finance bills. But a very big movement indeed in discount rates would be needed to warp the course of trade.

It is difficult to draw an exact line between a commercial bill and a finance bill. Bills drawn in

anticipation of shipments of goods—like the many bills drawn in America during the first half of the year by those who know that they will be able to cover themselves in the autumn when the cotton and cereal bills come forward—have already been given as an example on the border line. And at first sight the bills drawn on America to pay the dowry of an English Duchess, *née* Miss Potter of Texas, seem to have little connexion with commerce. But here I think we find the distinction that makes the real line. England has exported certain services to Miss Potter—a coronet and strawberry leaves, a position in what is called Society, and a husband. The fact that she comes here, as a rule, to enjoy them does not make them less an export, any more than the health and change and entertainment that France sells to English visitors are any less an export because the English visitors cross the Channel to fetch them. I think we may assume for the purposes of our classification that commercial bills are those drawn in the first place against goods exported; secondly, against any services rendered in connexion with the interchange of goods, such as freights, insurance and brokerages on produce; and thirdly, against any services

rendered in the widest sense of the word, such as the British exports of order and good government to certain of our dependencies, and the French exports referred to above, of the pleasures of travel. All these things ebb and flow in a more or less constant stream.

On the other hand, the finance bill is one drawn against the export of a promise to pay, whether in the shape of a Government loan or a railroad bond with a hundred years to run, or the implied understanding that the drawer will put the acceptor in funds to meet the bill, with a life of ninety days after sight, before its maturity. If we take this distinction as the dividing line, bills drawn in anticipation of shipments of goods are pure finance bills. They are not drawn against any definite claim for goods or services rendered, but merely against a promise to meet them some day somehow. The ebb and flow of the stream of finance bills runs up and down with the suddenness and strength of a freshet, and consequently their effects upon exchange rates are more marked than those produced by the bills drawn against goods or services.

Allusion has several times been made to the close connexion between market rates of discount

and the creation of finance bills. The finance bill pure and simple, and in its most usual sense, that is drawn on an English correspondent by an operator abroad who wants to finance himself for a time, obviously only comes into being when the rate at which he can raise money here compares favourably with the price that he would have to pay at home. Occasionally it may happen that a borrower of this kind will prefer to draw on London and sell his bill rather than finance himself at home in the ordinary way, even though he might do so more cheaply. He may prefer to borrow abroad because he can thus more easily cover his tracks. But as a rule the price that he pays for the loan will be his chief consideration, and this price will largely depend on the rate at which his bill can be discounted in London, for this influence, together with the rate for sight drafts, determines the price at which his bill can be sold in New York. A sixty days' bill on London is roughly worth the price of a draft payable at sight, less the discount rate ruling in London for bills of this usance. Hence it follows that a low rate of discount in London, which means that sixty days' or ninety days' bills can be sold there at good prices for cash, will stimulate the creation of finance bills.

The obviousness of this truism is still more self-evident when we consider the bills drawn on London by American or French houses under instructions from English firms who want to lend money in the United States or in France. Here a comparatively high rate of interest abroad is clearly the main incentive.

Bills drawn to supply a demand for exchange and in anticipation of an increase in the supply of commercial bills later on will also evidently be influenced by the market rate of discount in the centre drawn on, because the profit expected from the deal in exchange will be eaten into severely if the bill drawn now fetches a bad price because discount rates are high. So we find that in three important kinds of finance bills the market rate of discount is an important element in stimulating or checking their production.

As to bills drawn against exports of the more permanent kind of investments, the market rate of discount current at any moment is a less immediate influence, but it certainly has its effect. A low rate of discount, if continued for a long time, usually tends, unless its effect is offset by other influences, to produce a rise in the price of securities and a consequent increase in the production of

new ones, because a low rate of discount means that money is plentiful and cheap for speculators and speculative purchasers of new securities. The new securities created are likely to be in part at least foreign and colonial securities, the creation of which amounts to an import by England and implies the drawing of bills upon her, which have finance behind them. Ultimately these imports of securities by England tend, as we have seen, to be set off by exports of her goods and services which are taken by the borrowers to whom she has given credit, or by some one to whom the borrowers have passed the credit on. But the immediate effect of a low rate of discount and a consequent import of foreign securities is the creation of a batch of bills, the sale of which in the countries where they are drawn turns the exchanges against England.

Contrariwise, an abnormally high rate of discount will tend to stop this kind of import altogether. If money becomes sufficiently scarce and dear the creation of new securities comes to a standstill, because when money is scarce and dear the great mass of floating stock that is carried on borrowed money has to shrivel in price until part of it can find real buyers who will pay for it and

put it away. So prices of stocks tend to be flat when money rates are high, and the public appetite for new securities becomes very unreceptive and fastidious. The Stock Exchange sometimes says, "If you were to offer a guinea for a sovereign now, the public wouldn't take it," and this is because the public would have to pay too much for the use of the necessary sovereign. For a large part of every new issue that is placed, is generally placed with the help of borrowed money. It goes into the hands of professional dealers in securities, who hold it, largely with borrowed money, until such time as the investing public saves enough to take it off their hands and put it away.

The state of the discount market thus has a direct and important effect on the freedom or shyness with which all kinds of finance bills are created, most important, perhaps, in the case of the mere accommodation bill drawn on England by operators who want to raise the wind, and least so, but still considerable, in the case of bills drawn against exports of new securities by the borrowing countries.

If continued long enough, excessively low or high discount rates will also affect the fluctuations even of the great mass of bills drawn against

goods and commercial services. When I say low or high discount rates, I mean relatively low or high, as compared with those ruling elsewhere. When money is plentiful and cheap, and conditions are otherwise favourable, buyers of goods are confident and eager, knowing that they can finance their purchases readily and hold them for a time, if necessary, without their eating their heads off owing to the cost of monetary accommodation. It must be remembered, however, that discount rates are sometimes low because confidence is shaken and trade is bad. When this is so the cheap money influence may be ineffective for a long time. When money is scarce and dear, not only are buyers less confident and eager, but sellers become importunate and are sometimes forced to slaughter their stuff at a loss because they cannot afford to pay the price of financial lodgings for it. Internationally expressed, this means that cheap money, if it lasts long enough, will stimulate imports and a ready demand for foreign goods followed by free drawing of bills on England and a downward tendency in the exchanges; while dear money will bring out the goods of English merchants and send them abroad to be sold for what they will fetch and turn the

exchanges in our favour. But it must be remembered that, since the price of credit is a much smaller item in the calculations of a merchant or manufacturer than in those of a financier who is flying kites, the effect of money rates on international trade is much slower than on international financing.

It follows, then, that those who have to study and forecast the movements of exchange rates must master the movements of discount rates. Further, anyone who wants to forecast the movements of discount rates must watch the foreign rates of exchange, for the action and reaction of these rates one on the other is so constant and effective that it is often difficult to tell which is the dog and which is the tail, and which wags which. The strength of the influence of discount rates on the exchanges has already been shown. That of the exchanges on discount rates is equally quick and direct. When the foreign exchanges move against us, discount rates will inevitably tend to rise. This is so partly because an adverse movement in the exchanges means that a large number of bills are being drawn on us and sold abroad, and will in due course come forward to be discounted in London. Consequently bankers

and others who employ money in discounting bills are immediately inclined to ask a higher price for doing so, because they see that a big supply of bills is on the way, and that there will be plenty of employment for their money. And another reason why adverse foreign exchanges cause an upward twist in discount rates is the fact that if the movement goes far enough exports of gold from London will be threatened.

Such being the importance of discount rates to those who are studying the ups and downs of exchange, it is necessary to give here a short explanation of discount rates and their movements, though this is really a money-market subject, the full treatment of which would be outside our present purpose. Discount rates are the rates at which, as we have seen in a former chapter, the bills drawn on London from all parts of the world, payable at varying periods after sight or date, can be discounted and turned into cash in London as soon as they have arrived here and been accepted by the drawee. The custom of the market has increased the difficulties of the inexperienced student, by quoting the rate of discount that has to be deducted from the face value of the bill, rather than its present value in cash. If we

were told that a three months' bill for £100 were to-day worth £99 that would be quite a comprehensible quotation. But when we are given exactly the same information by being told that the rate for three months' bills is 4 per cent., this involves a certain amount of calculation and confusion in unaccustomed minds, though it is evidently a much more convenient method for those who are handling the business. The rate of discount is merely the rate of interest that the buyer of a bill due some time hence exacts on his investment. He knows that the bill will be worth £100 in three months' time; if you are the holder of it and want immediate cash, he will give you £99 for it and earn 4 per cent. per annum on his money, or rather a shade more, because he is getting £1 in three months on an investment, not of £100 but of £99.

These rates are established, like other prices, by bargaining between buyers and sellers and the relation between demand and supply. The supply of bills is provided, as we have seen, by the drawing of bills on London against goods and securities sold and services rendered to England by foreign countries, which are bought by dealers in exchange in foreign centres and

sold to those who have claims to meet in London against goods sold and services rendered by England to foreign countries. As the bills come forward by the mails that arrive day by day they are presented for acceptance by the London correspondents of those who have forwarded them, and are then turned into cash by being sold to a bill broker or discount company. These firms and companies, however, act to a great extent as intermediaries. They hold a certain number of bills in their own portfolios—The National Discount Company, for instance, showed in its latest balance sheet a net holding of nearly £13,000,000 — but they are like warehousemen holding a large stock of various goods to suit the taste of their customers.

The customers in this case, the ultimate buyers of most of the bills that come to London, are the big banks, members of the Clearing House and so known as the clearing banks. Out of their holdings the bill brokers and discount houses provide the banks with bills of the dates that their fancy makes them require. The money articles of the daily papers will sometimes tell you that the banks are confining their purchases of bills to those with short periods to run. This means that the

bankers, having arrived at the conclusion that the monetary outlook points to higher rates, are keeping their commitments short, and only buying bills which will mature within a few weeks, in the expectation of making a better bargain for the use of their money when the bills fall due. By so doing they throw on to the bill brokers and discount houses the burden of carrying the longer bills until the lapse of time makes them short enough to suit the bankers' fancy. In order to finance this burden the bill merchants will generally have to borrow money from day to day or for short periods, and this money they will borrow from the banks, so that herein is another influence that the bankers exert on the price of bills.

It thus appears that the demand of the banks for bills in relation to the supply of them usually settles the question of the discount rates. This demand is fairly constant since most of the banks have a rough notion of the proportion of their assets that they prefer to hold in bills; but it is more or less elastic since, when there is pressure on the banks for other forms of accommodation, they will be less eager buyers of bills and, even if they buy as many as usual, they will be more fastidious in the matter of rate and currency. The

demand of the banks for bills is thus tempered by the fact that bankers have many other means of employing their resources, and these factors have to be considered by those who study the course of discount rates. For instance, when Stock Exchange speculation is active or trade is abnormally busy, the banks have less temptation to buy bills, having other outlets for their money.

Another influence which complicates the problem is the extent of the foreign demand for bills. At times when discount rates in London are relatively high, foreign bankers make large investments in English bills, buying them either in their own markets, or, through their agents, in London.

When the student of exchange has mastered all the influences on the banks which cause them to raise or lower the rates at which they will discount bills, he has next to discover that he has not nearly come to the end of his problem. Discount rates depend, in ordinary times, on what the managers of the big clearing banks think ought to be the price of bills, and, occasionally, on the price at which foreign bankers will buy English bills; but every now and then there comes a time when the sceptre of the discount market passes out of their hands into those of the Bank of England.

It is part of the business of the Bank of England to watch over the London money market and regulate its rates, with a view to influencing rates of exchange and protecting London's reserve of gold, which the Bank of England has in its keeping. This it does either naturally or artificially. Naturally, when the supply of bills is greater than the demand for them by the banks, so that people with bills to sell have to send them to the Bank of England, which thus gets control of the market; artificially, when the directors of the Bank of England think that discount rates are too low, in view of the state of the foreign exchanges, or the size of their own reserve and its proportion to the bank's liabilities, and take control of the market by borrowing money from it and so creating artificial scarcity and producing a rise in market rates to something like the rate that the Bank of England quotes itself. When it does this the Bank of England is said to make its rate effective. These incursions by the Bank of England into the arena of the discount market make it necessary for students of exchange sometimes to consider what the directors of the Bank of England are going to think about the outlook; because the decisions of the Bank Court often have a great effect first on

discount rates and through them on rates of exchange.

If it should be asked why the Bank of England should have this heavy responsibility of regulating discount rates, and why the matter should not be left to work itself through the action and reaction of supply and demand? the answer is that if the market were left unregulated, and it were no one's business to see that it did not commit itself too deeply, the market would be likely to go merrily on buying finance bills and giving foreign borrowers claims to London's money, and then suddenly wake up to the fact that it had imported securities too fast, and that the exchanges were all down to gold point, and so London might lose much more gold than it liked before it could right matters by twisting rates up with a very uncomfortable jerk.

All the great financial countries have central banks whose business it is to regulate the money market, except America, where they are trying hard to get one, and call it by some other name. It is especially necessary for London, because London, when the exchanges go down to gold point, lets gold go, and so we come back to the importance, from the point of view of exchange, of

the fact that English money can always be turned into gold.

And why should gold not go? may very reasonably be asked. We can all go on quite comfortably drawing cheques, and the use of a metal in payments is a barbarous anachronism in a country with a properly ordered credit system. So it is, but as we only take cheques in payment because we know that we can turn them into gold if we want to, and as it occasionally happens that folk want gold and demand it, the existence of a certain amount of gold behind our credit system is, at present, an imperative necessity. We work on a much smaller gold basis than any other leading financial nation, and at the same time we are always prepared to hand the metal out when it is asked for, and so there is twofold need for vigilance on the part of those who have to keep the store.

Hence it is that discount rates in London are so sensitive to movements in the foreign exchanges. When the exchanges move against us, the banks are thereby checked in their readiness to buy bills at low rates, because they know that if the movement goes far enough, one of two things is likely to happen, either of which will make purchases of bills at low rates unprofitable. Either gold will

be taken, and so the supply of money will be lessened, because there is a rough proportion between the amount of gold held by the banks and the Bank of England and the amount of credit that is available; or else the Bank of England will intervene to check exports of gold and will do so by raising discount rates artificially. In either case there is likely to be a rise in discount rates which will make any bills bought at low rates before it happened look like a bad bargain.

The rise in discount rates being established, a favourable movement in the foreign exchanges will probably follow, for reasons already set forth, namely: Foreign capitalists abroad will have less temptation to raise money by drawing finance bills on London, because the price at which such bills can be sold will be lower; English capitalists will have less temptation to send money abroad, being able to employ funds profitably at home; and foreign capitalists abroad will have more temptation to send money to London, owing to the high rates to be obtained here. In consequence of these influences the tide of floating capital which seeks temporary investment first in one and then in another of the great financial centres, as it is swayed

by the rates offered to it, will tend in the direction of London. Fewer bills will be drawn on London, and the demand for bills on London will be keener abroad, owing to their being a more profitable investment in consequence of the rise in discount rates here. London will be exporting securities rather than importing them for the time being, and, as we have seen, every export tends to turn the exchanges in London's favour.

CHAPTER VIII

BULLION AND EXCHANGE

In the last chapter the method was described by which the Bank of England, as guardian of London's store of gold, works on the exchanges through the discount rate, and so when it thinks it necessary to do so tries to keep the foreign exchanges above the level which is commonly called gold point. This is the point, briefly referred to in Chapter II,* at which it is more profitable to bring gold over from London than to sell a bill on London.

For instance, according to Mr. Clare's table that was quoted from before, if the price in New York of a sight draft on London falls to $4{\cdot}83\frac{3}{4}$, London will lose gold to New York. The mint par, according to the same authority, is $4{\cdot}86\frac{2}{3}$ dollars to the pound sterling, and the difference between these two figures represents the cost of

* P. 36.

shipment and insurance, and the loss of interest during transport of the gold. In theory anyone who had a bill on London to sell would not take less than 4·83¾ dollars for every pound in it, but would send it to London to be cashed and bring the gold over to America and turn the gold into dollars on its arrival. In practice the business of gold shipment would be done by firms that make a special study of it and know all its ropes, and they would buy up bills on London so as to put themselves in funds there to meet their purchases of gold. By thus buying bills on London they would prevent the price of them from falling far below gold point. So when the supply of bills on London is excessive in relation to the demand, the consequent fall in their price brings in gold to restore the trade balance and quicken the demand for bills.

Mr. Clare's table, however, must be taken as only a rough sketch of the points at or near which gold shipments may perhaps be expected to happen, not as a diagram expressing hard and fast laws. As he himself puts it in a footnote to his table: "Owing to their elastic nature, gold points cannot be fixed with exactness. The net yield of a shipment of a given weight of gold

varies according to whether it consists of coin or bars, according to the bank's price for gold, according to the rate of interest ruling at the time, and even according to the speed of the steamer carrying it." It will also depend on the price of freight and insurance, the recent rise in which has widened the distance between the mint par and the theoretical gold point. But these variations do not alter the main basis of the problem, for the Londoner who has to pay money in New York, who always has to ask himself, "At what point will it pay me better to send gold than to buy dollars in New York with my sovereign here?" Practically the question will be answered by a professional expert, who will ship gold as soon as it pays to do so and have dollars in New York to sell as the result of his operation.

As we have seen already, a movement in the foreign exchanges up to the point at which, in theory, gold ought to come to London is by no means certain to be followed by imports of gold. With regard to the United States, theory and practice generally go hand in hand, since it is usually possible to get gold certificates and turn them into gold at the sub-Treasury. It must be remembered, however, that gold certificates are by

no means the only form of legal tender in the United States, so that a debtor can legally meet a claim there in pieces of paper which carry no claim to be turned into gold. And the monetary arrangements of the United States have hitherto been subject to occasional cataclysms, in the course of which it is not only impossible to get gold certificates, but all forms of legal tender money are suddenly found to have vanished underground, and nothing is to be had but a curious form of currency known as a clearing-house certificate.

In the case of France and Germany, as was pointed out in an earlier chapter, France charges a premium on gold whenever the Bank of France chooses to do so; and Germany takes measures so effective that the theoretical gold point is often reached without a penny-worth of gold being shipped. In other centres there is theoretical freedom up to a point, but the regular working of the theory which connects a certain level of exchange with remittances of gold cannot be backed as a certain winner, or even as a certain starter. And so it is that theoretical students who tell you that an exchange cannot move in London's favour

beyond a certain point because it would pay better to ship gold than to buy a bill, would be likely to burn their fingers if they put their opinions to a practical test.

When the wind is the other way the theory will work, but by no means with the regularity that might reasonably be expected from a self-respecting economic law. It is safe to assert that when the exchanges go down to the point at which it pays better to ship gold from London than to buy a bill, gold will go. But in the first place, experts always differ as to where that point begins; and in the second, gold often leaves London long before there is any question of its being the more profitable form of remittance. In fact, it may be asserted that the foreign exchanges very seldom go down to the export gold point, because gold begins to go before they can get there.

It has often happened to me, when I was a financial journalist and had to try to find out the how and why of gold movements, to ask several of the most experienced and well-informed cambists in the City whether a gold shipment which had taken place had been made as a genuine exchange transaction or was done for some other reason,

and to hear from one that there was a reasonable exchange profit on it, from another that there might be just a shade of a turn to be got out of it if you scraped it very hard with a knife, and from another that you could not find a particle of the profit in it if you put it under a microscope for a week. So many complications have to be considered, as Mr. Clare's note to his table has shown us, that the most eminent doctors may be pardoned for disagreeing.

It may be objected that dealers in exchange, and the comparatively few firms that make a special study of gold shipping, are not in the business for their health, and that shipments would not happen if there were not some profit in them. This is perfectly true, but the profit need not be got from the exchange. As an exchange transaction it only pays to ship gold to America when bills on London can only be sold in New York at a lower price than gold would fetch if brought from London and exchanged into dollars in New York. If bills on London are selling at 4·83¾, and gold can be bought and shipped and turned into dollars at the rate of 4·83⅞, after allowing for all charges and commissions and the loss of interest during transit, then the

operation pays as an exchange transaction. If the dollars realized by the gold were at the rate of only 4·83$\frac{3}{4}$ the importer would be no better off than if he had sold a bill; if they were at the rate of 4·83$\frac{5}{8}$ he would be out of pocket on the business, viewed strictly as an exchange transaction. But this is by no means the only consideration. Gold has such a magical fascination for moneyed mankind, and its movements are so eagerly discussed in their markets and newspapers, that it is often handled and shipped at a loss, especially in America, for the sake of the advertisement that the importing firm thereby gains for itself.

Moreover, imports of gold have a very stimulating effect on speculative stock markets, because an increase in the amount of gold available means a roughly corresponding increase in the amount of credit that bankers can give, so that when gold is known to be coming speculators know that credit will be cheaper for carrying their commitments, and will come in and buy, with a light heart, stock that they could not possibly pay for, but hope to pawn with their bankers until they can sell it at a higher price. And so unless the loss on the exchange side of the business is too great,

it often pays the leaders of a bull campaign to import gold, having first laid in a line of stock, and make their profit by unloading during the fit of exhilaration produced by the news that the gold is on the way.

Or, again, quite apart from any speculative and spectacular motives behind gold shipments, it may pay bankers, in a country where rates for money are ruling high, to import gold at an apparent loss, because of the high rates that they get for the credit that they are thereby enabled to give. They thus, in effect, borrow gold, and recoup themselves by being able to lend, on profitable terms, larger amounts than they borrow, since they can always create credit to larger amounts than that of the gold in their vaults. Sometimes, in fact, in times of pressure banks find themselves obliged to import gold so as to strengthen their position, whatever the loss on exchange may be.

For instance, last September, when the Berlin exchange was at the point at which, if theory ruled in these matters, Berlin ought to have been thinking of packing up some gold to send to London, Berlin was buying gold in London and shipping it to the Fatherland, because there is always great pressure for currency in Germany at the end of

September when the interest on mortgages falls due and has to be paid in cash, with the result that the Reichsbank's note circulation expands very rapidly and the backing of gold behind it has to be increased. Sometimes, again, in order to attract gold, a central bank will give importers credit for gold that is on the way, so that they may be saved from loss of interest while the metal is afloat. Thus the actual importer may make a profit on the shipment, not as a genuine exchange transaction, but at the expense of the central bank.

In these cases two of the many functions performed by gold have to be considered. As a means of international remittance, it may not be as cheap as a bill, but it may have to be sent, not as a means of remittance, but because it is urgently wanted in the importing country as a make-weight for the balloon of credit.

So we see that the grumbling bill broker who was quoted in an earlier chapter as saying that these confounded exchanges only work one way, was actually understating his case. Not only do we always lose gold when the exchanges go against us, and often get none when they go in our favour, but we also often lose gold long before the exchanges are sufficiently against us to justify

its going, and sometimes even when they are strongly in our favour.

The effect on the exchange of an import or export of gold is, of course, just the same as that of the import or export of any other commodity—an import turns the exchange against us and an export turns it in our favour. If we send gold, for example, to Germany we thereby meet a German claim on us or create a claim for ourselves on Germany; in the former case the bills drawn on us will be less by the amount of the gold shipped, and the supply in Berlin of bills on London will be less in relation to the demand, so that the tendency will be for the price of sovereigns, as expressed in marks, to rise. In the latter case some one in Berlin will have a claim to meet in London and will have to bid there for a bill on London, and his bidding will have the same beneficent effect on the exchange. When we import gold, whether brought out of bankers' vaults, or dug out of the bowels of the earth, the country that sends it to us meets claims of ours on it or establishes claims on us. In either case the tendency is for the exchange to move against us.

Before we leave this subject of the imports and

exports of gold, a very short explanation must be given of the bullion market, since variations in the price of gold are, as Mr. Clare has told us, often a factor in the question whether a gold shipment is profitable as an exchange transaction.

Since gold is, as we all know, the measure of value, and the price of everything else is expressed in gold, it is very puzzling when one first discovers that the price of gold, which is obviously expressed in itself, can vary. Evidently two pieces of gold of exactly the same weight and fineness, and in the same place, must always be equally valuable. But in England the measure of value is the coined sovereign, and it is quite natural, when you think it over, that the price of uncoined gold in bars should vary when expressed in coined sovereigns.

For purposes of export, except to Egypt, India, and some South American countries, it is the uncoined bar gold that is preferred. Anyone who takes sovereigns has to take them in England by tale—that is, for every pound of his cheque or bank balance he takes one sovereign. But when they cross the sea the sovereigns are valued purely by the weight of gold in them, and some of them may not have been quite up to weight when they started,

and it is still more likely that some will not be up to weight when they arrive, having suffered all the wear and tear of packing and unpacking. Moreover, before they can be turned into legal tender in their new home they generally have to be melted down and re-coined, and this is a matter that involves time and further wear and tear. For these and other reasons bar gold is the commodity that is preferred by exporters, or better still, coins of the country to which the gold is to go.

Coins of the chief financial countries are usually to be had at the Bank of England, which sells them by weight at prices that it names periodically. Exports of gold are often heralded by tentative inquiries at the Bank concerning the price at which it would be prepared to sell American eagles or German or French gold coin. Bar gold is to be had in the bullion market, which consists of three or four firms which specialize in trading in gold and silver. The market is fed chiefly by the weekly arrivals of raw gold from the Transvaal mines, which come in on Saturday in the mail boat from the Cape, and are dealt with on the following Monday. On arrival, the gold comes up from Southampton to London by train and is left at the Bank of England till Monday. It is then

taken by a refiner, who has bought it from the South African bank, to which it was consigned. It is then sold in the market by a bullion broker on behalf of the refiner to the highest bidder, and either delivered to him when refined, or shipped on his account if he be a foreign buyer. If there are no buyers in the market, the refiner sells the gold to the Bank of England, which pays for it with a cheque on itself. There are two buyers whose demand is almost constant, and who always take toll of each shipload. These are India and "the trade." India because India is and has been, according to a writer on currency history, "from the birth of international commerce, the receptacle or sink for the precious metals of the civilized Western world."* India's power to absorb bar gold, in little bars specially cooked to a high polish, is apparently inexhaustible. Every week they go out to the East to be sold in the bazaars and hoarded by the natives. Students of Herodotus will remember a curious passage in which he describes how the Indians of his day used to get gold-dust turned up by ants in making their heaps. The gold-seekers of those days used to raid the ant-heaps in the hottest part of the day

* W. A. Shaw, "The History of Currency," p. 293.

when the ants had gone underground to escape the heat of the sun, and then gallop away on fleet camels. For the ants were not only, according to the historian's usual precision, "smaller than dogs but bigger than foxes," but also incredibly swift, so that none of the gold gatherers would escape if they did not get away while the ants were mustering to avenge the attack on their heaps.*

"The trade" means the goldsmiths through whose hands the metal moves on its way to become bracelets or racing-cups, or gilding for picture frames or stoppings for teeth. Other buyers are usually the agents of foreign banks that want gold because it pays to send it as a matter of exchange, or for other reasons. One or two of the big clearing banks have lately taken to dealing a little in bar gold, buying it when it is cheap, holding it as part of their cash reserves and selling it when the price rises, as it does in time of keen demand.

Bar gold cannot fall below *77s. 9d.* per ounce in price, because at that price the Bank of England is bound by law to buy any amount that is offered to it. The value of bar gold in coined sovereigns is *77s.* $10\frac{1}{2}$*d.* per ounce, and any one can take bar gold to the Mint and have it coined,

* Herodotus III. 102, 105.

gratuitously, at that rate. But as coining takes time, in the meantime the gold would be earning no interest, owners of the raw stuff who cannot dispose of it to someone who will bid higher, usually prefer to sell their bars outright to the Bank of England at the lower price of *77s. 9d.* The $1\frac{1}{2}d.$ extra that the gold is worth when coined is the discount or demurrage charge that goes to the Bank of England.

Consequently when the exchanges are nearing the point at which it pays to export gold, the fate of the weekly parcel of bar gold—which sometimes comes to more than £1,000,000 worth—is always eagerly canvassed by the discount market and by every one who is interested in the price of money. If there are no foreign buyers who snap the gold up at something over *77s. 9d.*, the bars, less the comparatively small amount that goes to India and the trade, will go to the Bank of England, whose reserve will thereby be strengthened. Someone, moreover, will have so much more to his credit at the Bank of England, and so, unless other more powerful influences are at work on the other side, money will be more plentiful, the discount market will be easier, the stock markets will be more cheerful, and a sort of aureolic smile will pass over the face of the City.

If there is competition for the bars, the price of them may rise to a considerable premium over their minting value. It is sometimes stated in treatises on the subject that the price cannot rise above 77*s.* 10½*d.*, because above that price it would pay better to take sovereigns from the Bank of England. But in practice the price of bars sometimes touches 78*s.* per ounce, owing to the reasons given above which make bars better than sovereigns as a commodity for export.

In late years the Bank of England has itself, at times when its reserve needed strengthening, come forward as a competitor in the bullion market and bid against other buyers, though it rarely goes higher than 77*s.* 9⅜*d.* per ounce, which price covers the bullion broker's commission, and cost of assay and refining. Whether it should do so, or should confine itself to influencing the exchanges through the discount rate, is a matter which has been copiously controverted in the City, but is wide of our present purpose. By so doing it tends to keep the exchanges against us, so that its occasional adoption of this policy is one of the countless influences with which he must reckon, who tries to forecast the course of the exchanges.

It is also interesting to note that these incursions

by the Bank of England into the bullion market sometimes lead foreign critics to question London's claim to a free market in gold. Mr. Franklin Escher, whose book on the "Elements of Foreign Exchange" has already been quoted, develops this argument as follows:

"The new gold coming from the mines does, it is true, find its way to London, for the purpose of being auctioned off to the highest bidder, but as the kind of bids which can be made are governed so largely by arbitrary action on the part of the Bank of England, it is a question whether the gold auction can be said to be 'free.' Suppose, for instance, that the 'Old lady of Threadneedle Street' decides that enough gold has been taken by foreign bidders and that exports had better be checked. Instantly, the bank rate goes up, making it harder for the representatives of the foreign banks to bid. Should the rise in the rate not be sufficient to affect the outside exchange on London, the Bank will probably resort to the further expedient of entering the auction for its own account and outbidding all others. Not having any shipping charges to pay on this gold it buys, the Bank is usually able to secure all the gold it wants —or, rather, to keep anybody else from securing it. The auction is open to all, it is true, but being at times conducted under such circumstances, is hardly a market which can be called 'free.'"*

* P. 126.

If no market is free in which the local buyer, who has not to meet the cost of carrying his goods to a far country, is at an advantage, it would be difficult to find a free market in anything anywhere. But Mr. Escher has perhaps misunderstood what English bankers mean when they claim a free market in gold in London. What they mean is that any one who is owed so much money in England can demand gold, with the certainty of getting it. Foreign buyers of gold in London, if they cannot satisfy themselves in the bullion market, can always demand payment of any balances that they have here in sovereigns or Bank of England notes, which the Bank must turn into sovereigns, though Mr. Escher, a good American rather than an accurate economist, claims that the one country where gold can be had without question is the United States.

"If," he says, "there is any 'free' gold market in the world, indeed, it is to be found in the United States. All anybody who wants gold in this country has to do, is to go around to the nearest sub-Treasury and get it. If the supply of bars is exhausted, the buyer may be disappointed, but that has nothing to do with any restriction on the market. The market for gold bars in the United States is at the Treasury and

the various sub-Treasuries, and as long as the prospective buyer has the legal tender to offer, he can buy the gold bars which may be on hand. And at a fixed price, regardless of how urgent the demand may be, who he is, or who else may be bidding. First come first served is the rule, and a rule which is observed as long as the bars hold out. After that, whoever still wants gold can take it in the form of coin."

In England any one who is owed money can get sovereigns without question and can buy bars if he likes to bid a high enough price in the bullion market. When the bullion market is exhausted he can go to the Bank of England and bid it a price for its bar gold, but it can charge any price that it likes and is not bound to sell its bars at all. What it is bound to do is to hand out sovereigns for any of its notes that are presented to it for payment.

CHAPTER IX

CONCLUSION

This merely introductory treatise makes no claim to cover all the confusing technical details which have to be mastered by those who have to handle the actual business of foreign exchange. To do so would involve a mass of arithmetical complications that would terrify and bewilder the inquirer and distract his mind from the broad problems that have to be understood before the technical details can be applied with success. Those who wish to pry further into the mysteries of the matter are advised to study Mr. Clare's "A.B.C. of the Foreign Exchanges," * and Mr. Escher's "Elements of Foreign Exchange," † and it goes without saying that every one who is interested in the subject ought, if he has not done so, to read the late Lord Goschen's masterly and illuminating "Theory of the Foreign

* Macmillan. † Effingham Wilson.

Exchanges."* All that I have tried to do is to show what foreign exchange means, why people in any country want to buy or sell the money of other countries, how it is done, and the main causes which sway the prices that are paid for the monies of other countries in any given centre.

To the ordinary student, who is not groping his way into the subject of foreign exchange with a view to gaining his living, the chief advantage to be got from a study of its problems is probably a closer grasp of the elementary fact, so often overlooked, that international trade is an exchange of goods and services between the different peoples of the world. In normal conditions, every bill drawn by an exporter on a foreign country will find its buyer, because every export will be met by an import in some form or another.

It does not follow that the country to which the export goes will provide the goods or services or coupons or securities that will be imported ; but for everything that goes out something or other must come in, if the buying country is to pay for what it receives. If China exports to Peru it will draw a bill either on Peru or more probably on London. In either case, a study of foreign

* Effingham Wilson.

exchange tells us that Peru will have to make some sort of export, to give her a claim abroad wherewith to meet the bill. If she cannot do so Peru's currency will be depreciated, and if the process goes on long enough the matter will right itself by Peru's no longer offering a field to the Chinese or other exporter.

So a study of the problems of foreign exchange teaches us to gaze with scepticism at the lurid pictures that are sometimes drawn of the days when cheap Oriental labour will flood Europe's markets with goods at prices which will shut up all her factories. Who will buy the bills that the Oriental exporters will draw? In other words, what will the Oriental producers take in return for their goods? If they take our gold it will be of no use except to buy goods and services withal. If they take our securities we cannot remit the interest unless they take goods and services from us in payment. If they take goods and services, some of our factories and places of business must open their doors again.

This interchange of services and goods that is at the back of the problem of foreign exchange must also surely show us how closely knit the

nations are in one commercial family, and how each one benefits by the prosperity of the rest. They are all buying from and selling to one another as fast as they can, and they do so because it makes them all better off. When Tom Sawyer exchanged the tooth that his aunt had just pulled out of his head for Huckleberry Finn's tick, the two boys "separated each feeling wealthier than before." They not only felt but were wealthier, because Tom had got a tick that he wanted more than his tooth, and Huck had got a tooth that he prized more highly than his tick. So it is with the nations.

Finally, we have seen what a great mass of business the activity of foreign trade brings to London, and how London takes toll of the commerce of the world by financing it through bills drawn on her accepting houses, and discounting the bills. To cite further foreign witnesses on this point, let me quote the following from a pamphlet lately published in Valparaiso, entitled "Chile, 1851-1910," by Agustin Ross:—

"Although the exporters may send their goods to different countries, yet, if they can draw upon London, their bills will be sure to find some purchasers somewhere, to be remitted to England.

"Guyot says: 'The City is not only the financial centre of the British Empire but also of the world.'

"This is not merely a saying: it is a fact. A Bill drawn upon London is a system of international exchange recognized by the whole world. Every exporter sells to his local bank his draft upon London although his merchandise may be sent to other countries and not to England.

"The Chinese merchant who sells his tea to Russia or Germany, his silk to the United States, is reimbursed through the London Market; and the same thing happens with the German merchant who sells his goods to China. The coffee exported from Brazil to France and Italy, the cotton sent from New Orleans to Poland, the sulphur that goes from Sicily to the United States, the agricultural machinery sent from the United States to the Argentine Republic—all these transactions are liquidated in 'The City.'"

With these stimulating facts before us, and after a contemplation of the enormous mass of the world's interchanges of goods and services and securities, financed by the marvellous bits of paper that pass current because somebody's name is written across them, those of us who work in the City may cheer ourselves with the thought that we are parts of one of the most wonderful machines that ever was set going, and that an element of romance and even of miracle lurks behind the daily table of rates of exchange. And it will be easier for

us to cast out of our minds the parochial view of foreign trade and the delusion that one nation can benefit from the poverty or decline of another, for we shall know that what Antonio said of Venice is true to-day of London, and that—

> "The trade and profit of the City
> Consisteth of all nations." *

* "Merchant of Venice," Act III. Scene 3.

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